

For purposes of the Undertaking, a beneficial owner of a bond includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares investment power which includes the power to dispose, or to direct the disposition of, such bond, subject to certain exceptions as set forth in the Undertaking. Any assertion of beneficial ownership must be filed, with full documentary support, as part of the written request described above.

Prior Continuing Disclosure Non-Compliance

The Authority has made similar continuing disclosure covenants in connection with prior Power Revenue Bond issues. Although the Authority has filed all reports and financial statements required to be filed, some filings have been made after the filing deadlines. Said exceptions are hereby noted.

Financial Statements

The Authority's audited financial statements for the fiscal year ended June 30, 2012 were filed on June 4, 2013 after the Authority's filing deadline as a result of delays caused by the transition of a new administration and new management team.

The Authority's audited financial statements for the fiscal year ended June 30, 2009 and material quantitative historical data on the Authority's System and finances were inadvertently not timely filed with EMMA by the deadline of April 1, 2010. The Official Statement for the Series XX Bonds, dated March 26, 2010, contained all the information required to comply with the Authority's continuing disclosure obligation and was filed with EMMA on April 5, 2010 to comply with MSRB rules and on April 13, 2010 specifically to comply with the Authority's continuing disclosure obligation.

Rating Changes

The Authority has reported in a timely manner all rating changes affecting its Power Revenue Bonds that do not have bond insurance. In these instances the Authority has been notified by the rating agencies of rating changes and notice of such changes has been filed with EMMA within the next ten business days. However, the Authority has not filed within ten business days rating changes affecting bond insurers insuring certain of the Power Revenue Bonds. The Authority does not receive direct official notification from the applicable rating agency(ies) that the insured ratings have been changed. For that reason the Authority filed once it became aware of the change but did not comply with the within ten business days filing requirement.

The Authority has filed rating change notices with EMMA on November 1, 2010 and December 9, 2011 in connection with rating changes related to Assured Guaranty Municipal Corp. and Assured Guaranty Corp. ("Assured"). These filings were made within ten business days from the issuance of a report from the rating agencies changing Assured's rating. However, the Authority filed with EMMA on June 21, 2013 a rating change notice related to an Assured rating change report that was issued on January 17, 2013. Although the document was executed on January 25, 2013, which was with ten business days from the issuance of the ratings report, the Authority inadvertently did not file it in a timely manner.

The Authority filed with EMMA on July 25, 2013 a ratings change notice relating to rating changes of bond insurers insuring certain Power Revenue Bonds of which the Authority was not notified prior to that date.

The Authority has established new policies and procedures that it believes will ensure full and timely compliance with all continuing obligations in the future.

MISCELLANEOUS

The foregoing summaries of or references to certain provisions of the Trust Agreement, the various acts and the Bonds are made subject to all the detailed provisions thereof to which reference is hereby made for further information and do not purport to be complete statements of any or all of such provisions.

There are appended to this Official Statement (i) a summary of the Trust Agreement, (ii) the financial statements of the Authority for the fiscal years ended June 30, 2012 and 2011, together with the independent accountants' report of Ernst & Young LLP, San Juan, Puerto Rico, (iii) a letter from the Authority's Consulting Engineers, URS Corporation, regarding its opinion as to certain engineering matters in this Official Statement, and (iv) the proposed form of opinion of Sidley Austin LLP, Bond Counsel.

The information set forth in this Official Statement, except for certain information on the page following the inside cover page and the information appearing in UNDERWRITING, MATERIAL RELATIONSHIPS, Appendices III and IV, and the information pertaining to DTC was supplied by the Authority. The information pertaining to DTC was supplied by DTC.

This Official Statement will be filed with the MSRB through EMMA.

PUERTO RICO ELECTRIC POWER AUTHORITY

By: _____ /s/ Juan F. Alicea-Flores
Executive Director

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APPENDIX I

DEFINITIONS OF CERTAIN TERMS AND SUMMARY OF CERTAIN PROVISIONS OF THE TRUST AGREEMENT

This Appendix contains summaries of certain provisions of the Authority's Trust Agreement. This summary is not to be considered a full statement of the terms of the Trust Agreement and accordingly is qualified by reference to such Trust Agreement and subject to the full text thereof. Capitalized terms not otherwise defined herein have the meanings set forth in the Trust Agreement or the Official Statement.

DEFINITIONS OF CERTAIN TERMS

The following are definitions of certain terms defined in Section 101 of the Trust Agreement and used in this Official Statement.

“Accreted Value” means with respect to any Capital Appreciation Bonds (i) as of any Valuation Date, the amount set forth for such date in the resolution authorizing such Capital Appreciation Bonds and (ii) as of any other date, the sum of (a) the Accreted Value on the preceding Valuation Date and (b) the product of (1) a fraction, the numerator of which is the actual number of days having elapsed from the preceding Valuation Date and the denominator of which is the actual number of days from such preceding Valuation Date to the next succeeding Valuation Date and (2) the difference between the Accreted Values for such Valuation Dates.

“Amortization Accrual” means for any period the amount of an Amortization Requirement that would accrue during such period if such Requirement accrued ratably on the basis of a year consisting of twelve (12) thirty-day months. Unless otherwise provided by the Authority, the monthly Amortization Requirement accrual for a term bond begins on the first day of each month in the fiscal year for which such Requirement has been established and ends on the first day of the month succeeding the relevant Deposit Day.

As applied to the term bonds of any Series, “Amortization Requirement” for any fiscal year means the principal amount fixed or computed for such fiscal year for the retirement of such term bonds by purchase or redemption.

The Amortization Requirements for the term bonds of each Series shall be initially the respective principal amounts for each fiscal year as fixed in a resolution of the Board adopted prior to the issuance of the bonds of such Series. The aggregate amount of such Amortization Requirements for the term bonds of each Series shall be equal to the aggregate principal amount of the term bonds of such Series.

If at the close of any fiscal year the total principal amount of term bonds of any Series retired by purchase or redemption, or prior to the close of such fiscal year called for redemption, shall be in excess of the amount of the Amortization Requirements for the term bonds of such Series for such fiscal year, then the amount of the Amortization Requirements for the term bonds of such Series shall be reduced for such subsequent fiscal years in such amounts aggregating the amount of such excess as shall be determined by the Executive Director in an order filed with the Trustee on or before the 10th day of July following the close of such fiscal year.

If at the close of any fiscal year the total principal amount of term bonds of any Series retired by purchase or redemption, or called for redemption, prior to the close of such fiscal year shall be less than the amount of the Amortization Requirements for the term bonds of such Series for such fiscal year, then the amount of the Amortization Requirements for the term bonds of such Series for the next succeeding fiscal year shall be increased by the amount of the excess of such deficiency over the amount then held to the credit of the Redemption Account.

The Trustee is required, on or before the 15th day of July in each fiscal year, to compute the Amortization Requirements for the then current fiscal year for the term bonds of each Series then outstanding. The Amortization Requirement for the then current fiscal year shall continue to be applicable during the balance of such current fiscal year and no adjustment shall be made during such year by reason of term bonds purchased or redeemed or called for redemption during such current fiscal year.

“Annual Budget” means the Authority’s budget of Current Expenses and Capital Expenditures for a fiscal year adopted pursuant to the provisions of the Trust Agreement.

“Board” means the governing board of the Authority as constituted from time to time and defined in the Act, or if said Board shall be abolished then the Board, body or officer succeeding to the principal functions thereof or to whom the powers of the Authority shall be given by law.

“Build America Bonds” means a series of bonds designated as “Build America Bonds” by the Authority for purposes of the Code and for which the Authority has irrevocably elected under the Code to receive the Federal Subsidy from the United States Treasury in connection therewith and apply it in accordance with the provisions of the resolution or resolutions adopted by the Board authorizing the issuance of such bonds.

“Capital Appreciation Bonds” means any bonds as to which interest is payable only at the maturity or prior redemption of such bonds. For the purposes of (i) receiving payment of the redemption price if a Capital Appreciation Bond is redeemed prior to maturity, or (ii) receiving payment of a Capital Appreciation Bond if the principal of all bonds is declared immediately due and payable following an event of default under the Trust Agreement, or (iii) computing the principal amount of bonds held by the registered owner of a Capital Appreciation Bond in giving to the Authority or the Trustee any notice, consent, request, or demand pursuant to the Trust Agreement for any purpose whatsoever, the principal amount of a Capital Appreciation Bond shall be deemed to be its Accreted Value. In the case of Capital Appreciation Bonds that are convertible to bonds with interest payable prior to maturity or prior redemption of such bonds, the term “Capital Appreciation Bonds” shall be limited to the period prior to such conversion, and after such conversion, the bonds shall be viewed as any other bonds of the same type for purposes of the Trust Agreement.

“Current Expenses” means the Authority’s reasonable and necessary current expenses of maintaining, repairing and operating the System, including, but not limited to, all administrative expenses, insurance premiums, expenses of preliminary surveys not chargeable to capital expenditures, engineering expenses relating to operations and maintenance, fees and expenses of the Trustee and the Paying Agents, legal expenses, any payment to pension or retirement funds, and all other expenses required to be paid by the Authority under the Trust Agreement or by law, or permitted by standard practices for public utility systems, similar to the properties and business of the Authority, but shall not include any deposits to the credit of the Sinking Fund, the Reserve Maintenance Fund, the Subordinate Obligations Fund, the Self-insurance Fund and the Capital Improvement Fund.

“Deposit Day” means the date by which all of the moneys then held to the credit of the Revenue Fund shall be withdrawn by the Treasurer and deposited in the manner set forth under “Disposition of Revenues” below.

“Designated Maturity Bonds” means the indebtedness incurred by the Authority under the terms of a separate trust agreement or resolution, which indebtedness has a maturity of at least ten (10) years and is secured, as to the unamortized principal thereof, on a subordinate basis to the bonds and for which (i) no amortization of principal has been established or (ii) the aggregate amount of the amortized principal that has been established is less than the principal amount of the indebtedness; provided that interest on said indebtedness and any amortized principal of said indebtedness may be payable on a parity, respectively, with interest on bonds and Amortization Requirements on term bonds, in which case said interest and amortized principal shall be included in the calculation of Principal and Interest Requirements on bonds for purposes of the Trust Agreement and shall otherwise be deemed to be, and be payable as, interest and Amortization Requirements on bonds for purposes of the Trust Agreement.

“Extendible Maturity Bonds” means bonds the maturities of which, by their terms, may be extended by and at the option of the bondholder or the Authority.

“Federally Subsidized Bonds” means either Build America Bonds or Other Subsidy Bonds or both, as the case may be.

“Federal Subsidy” means a payment made by the Secretary of the Department of Treasury to or for the account of the Authority pursuant to the Code in respect of a series of bonds constituting Federally Subsidized

Bonds. Any Federal Subsidy to be received by the Authority in respect of such series of bonds shall be identified as such in the resolution authorizing the issuance of such series of bonds.

“Federal Subsidy Payments” means the amount of Federal Subsidy actually paid to and received by the Trustee in respect of an interest payment for the Federally Subsidized Bonds to which such amount relates. Such Federal Subsidy Payments shall be deposited directly into the Bond Service Account in the Sinking Fund.

“Government Obligations” means (i) direct obligations of, or obligations the principal of and the interest on which are unconditionally guaranteed by, the United States Government including securities evidencing ownership interests in such obligations or in specified portions thereof (which may consist of specific portions of the principal of or interest on such obligations), (ii) bonds, debentures or notes issued by any of the following Federal agencies: Banks for Cooperatives, Federal Intermediate Credit Banks, Federal Home Loan Banks, Export-Import Bank of the United States, Government National Mortgage Association, Federal Land Banks, or the Federal National Mortgage Association (including participation certificates issued by such Association) and (iii) all other obligations issued or unconditionally guaranteed as to principal and interest by an agency or person controlled or supervised by and acting as an instrumentality of the United States Government pursuant to authority granted by the Congress.

“Improvements” means improvements, renewals and replacements of the System or any part thereof and such extensions and additions thereto as may be necessary or desirable, in the judgment of the Board, to keep the same in proper condition for the safe, efficient and economic operation thereof and to integrate into the System any unit or part thereof, and shall include such electric-power projects as may be authorized to be acquired or constructed by the Authority under the provisions of the Act and such improvements, renewals and replacements of such properties and the System and such extensions and additions thereto as may be necessary or desirable for continuous and efficient service to the public, which shall be financed in whole or in substantial part from the proceeds of bonds issued under the provisions of the Trust Agreement or from moneys deposited to the credit of the Construction Fund or the Renewal and Replacement Fund.

“Independent Consultant” means the consultant or consulting firm at the time employed by the Authority to perform and carry out the duties of the Independent Consultant under the Trust Agreement.

“Interest Accrual” means for any period the amount of interest that would accrue during such period if such interest accrued ratably on the basis of a year consisting of twelve (12) thirty-day months. Unless otherwise provided by the Authority, the monthly accrual in respect of interest on the bonds shall commence on the later to occur of the date of issue of the bonds of such Series and the date that is six months prior to the due date of such interest and shall end on the first day of the month following the relevant Deposit Day.

“Investment Obligations” means (i) Government Obligations, (ii) obligations of any state or territory of the United States or political subdivision thereof (other than obligations rated lower than the three highest grades by a nationally recognized rating agency), (iii) repurchase agreements with commercial banks fully secured by Government Obligations and (iv) any other investment obligations permitted for governmental instrumentalities under the laws of the Commonwealth which are rated, on the date of investment therein, in any of the three highest grades by a nationally recognized rating agency or which are collateralized by any other Investment Obligations.

“Net Revenues” means, for any particular period, the excess of the Revenues for such period over the Current Expenses for such period.

“Other Subsidy Bonds” means bonds for which a subsidy or other payment made by the Secretary of the Department of Treasury may be made in respect of such bonds other than under Section 6431 of the Code.

“Prerefunded Municipals” means any bonds or other obligations of any state of the United States of America or the Commonwealth or of any agency, instrumentality or local governmental unit of such state or the Commonwealth (a) which are (x) not callable prior to maturity or (y) as to which irrevocable instructions have been given to the trustee of such bonds or other obligations by the obligor to give due notice of redemption and to call such bonds or other obligations for redemption on the date or dates specified in such instructions, (b) which are secured as to principal, redemption premium, if any, and interest by a fund consisting only of cash or Government

Obligations or Time Deposits, secured in the manner set forth in the Trust Agreement, which fund may be applied only to the payment of such principal of and interest and redemption premium, if any, on such bonds or other obligations on the maturity date or dates thereof or the specified redemption date or dates pursuant to such irrevocable instructions, as appropriate, and (c) as to which the principal of and interest on such Government Obligations or Time Deposits, secured in the manner set forth in the Trust Agreement, which have been deposited in such fund, along with any cash on deposit in such fund are sufficient to pay principal of and interest and redemption premium, if any, on the bonds or other obligations on the maturity date or dates thereof or on the redemption date or dates specified in the irrevocable instructions referred to in clause (a) above, as appropriate.

“Principal Accrual” means for any period the amount of principal that would accrue during such period if such principal accrued ratably on the basis of a year consisting of twelve (12) thirty-day months. Unless otherwise provided by the Authority, the monthly accrual in respect of the principal of serial bonds shall commence on the first day of the twelfth month preceding the due date of such principal and shall end on the first day of the month succeeding the relevant Deposit Day,

“Principal and Interest Requirements” means, for any fiscal year, as applied to the bonds of any Series issued under the Trust Agreement, the sum of:

- (a) the amount required to pay the interest on all outstanding bonds of such Series which is payable on January 1 in such fiscal year and on July 1 in the following fiscal year,
- (b) the amount required to pay the principal of all outstanding serial bonds of such Series which is payable after July 31 in such fiscal year and on or prior to July 31 in the following fiscal year, and
- (c) the Amortization Requirement for the term bonds of such Series for such fiscal year.

The Principal and Interest Requirements shall be determined as required from time to time, by the Trustee. In computing the Principal and Interest Requirements for any fiscal year for the bonds of any Series, the Trustee shall assume that an amount of the term bonds of such Series equal to the Amortization Requirement for the term bonds of such Series for such fiscal year will be retired by purchase or redemption not later than July 1 in the following fiscal year.

Principal and Interest Requirements on bonds shall be deemed to include the amount required to pay interest on outstanding Designated Maturity Bonds and any amortized principal of said Designated Maturity Bonds for any fiscal year, if said interest and amortized principal are payable on a parity with interest and Amortization Requirements on bonds.

To the extent all or a portion of the principal of, Amortization Requirements for or interest on, any bonds of any Series are payable from moneys irrevocably set aside or deposited irrevocably for such purpose with a bank or trust company (which may include the Trustee) or from Investment Obligations or Time Deposits, secured in the manner set forth in the Trust Agreement, irrevocably set aside for such purpose, the principal of and the interest on which when due will provide sufficient moneys to make such payments, such principal, Amortization Requirements or interest shall not be included in determining Principal and Interest Requirements; provided, however, that for purposes of compliance with the Authority’s rate covenant (see “Rate Covenant” below) said definition shall include any interest payable from any amount deposited to the credit of the Bond Service Account in the Sinking Fund from the proceeds of bonds to pay interest to accrue thereon. Upon request of the Trustee, the Authority shall cause to be delivered to the Trustee a certificate of an independent verification agent as to the sufficiency of the maturing principal amounts of any Investment Obligations or Time Deposits, together with interest thereon, set aside or deposited to pay said principal, Amortization Requirements and interest. If the Authority has notified the Trustee that a SWAP agreement is in effect in respect of Variable Rate Bonds, then for all purposes of this paragraph, except for the purpose of determining the aggregate Principal and Interest Requirements in the covenant as to rates (see “Rate Covenant” below), the interest rate on such Variable Rate Bonds shall be the SWAP rate under such SWAP agreement.

For purposes of determining the maximum Principal and Interest Requirements and the aggregate Principal and Interest Requirements in the covenant as to rates, on the date of issuance of a Federally Subsidized Bonds and for so long as the Trustee shall receive the scheduled amount of the Federal Subsidy Payments on or before such interest is payable, all or a portion of the interest in respect of one or more series of Federally Subsidized Bonds shall be excluded from the calculation of the Principal and Interest Requirement if, and to the extent that the interest thereon is payable from a Federal Subsidy. Notwithstanding the foregoing, if the Trustee shall not receive the scheduled amount of the Federal Subsidy Payments on or before the date interest on such Federally Subsidized Bonds is payable or within thirty (30) of the date such Federal Subsidy Payments were scheduled to be received under the then current applicable law and regulations, then from and after the occurrence of such failure and until such Federal Subsidy Payments shall resume and all prior deficiencies are cured, the exclusion from the calculation of the Principal and Interest Requirement set forth in the preceding sentence shall no longer be effective for such purposes.

For purposes of determining the aggregate Principal and Interest Requirements in the aforementioned covenant as to rates, and the maximum aggregate Principal and Interest Requirements for purposes of asset dispositions and the issuance of additional Power Revenue Bonds (including refunding bonds), subject to the last sentence of the second preceding paragraph, the interest rate on Variable Rate Bonds shall be assumed to be one hundred ten percent (110%) of the greater of (i) the average interest rate on such Variable Rate Bonds during the twelve months ending with the month preceding the date of calculation or such shorter period that such Variable Rate Bonds shall have been outstanding, and (ii) the rate of interest on such Variable Rate Bonds on the date of calculation. If Variable Rate Bonds are payable at the option of the bondholder and the source for payment of said put is a credit or liquidity facility, the "put" date or dates shall be ignored and the stated dates for Amortization Requirements and principal payments thereof shall be used for purposes of this calculation.

For purposes of determining the above requirements in the case of Put Bonds, the "put" date or dates shall be ignored if the source for payment of said put is a credit or liquidity facility and the stated dates for Amortization Requirements and principal payments shall be used. For purposes of determining the above requirements in the case of Extendible Maturity Bonds, the bonds shall be deemed to mature on the later of the stated maturity date or the date to which such stated maturity date has been extended. For purposes of determining the above requirements in the case of Capital Appreciation Bonds, the principal and interest portions of the Accreted Value of Capital Appreciation Bonds becoming due at maturity or by virtue of an Amortization Requirement shall be included in the calculations of accrued and unpaid interest and principal requirements in such manner and during such period of time as is specified in the resolution authorizing such Capital Appreciation Bonds.

Principal and Interest Requirements shall be deemed to include the amount required to pay interest on outstanding Designated Maturity Bonds and any amortized principal of said Designated Maturity Bonds for any fiscal year, if said interest and amortized principal are payable on a parity with interest and Amortization Requirements on bonds.

"Put Bonds" means bonds, other than Variable Rate Bonds, which by their terms may be tendered by and at the option of the holders thereof for payment prior to the stated maturity thereof.

"Reserve Account Insurance Policy" and "Reserve Account Letter of Credit" mean (1) the insurance policy, surety bond or other acceptable evidence of insurance, if any, or (2) the irrevocable, transferable letter of credit, if any, respectively, deposited in the Reserve Account in lieu of or in partial substitution for cash or securities on deposit therein, for the purpose of making the payments required to be made from the Reserve Account under the Trust Agreement. The issuer providing such insurance or letter of credit shall be a municipal bond insurer or a banking association, bank or trust company or branch thereof whose policy or bond or letter of credit results in the rating of municipal obligations secured by such policy or bond or such letter of credit, respectively, to be rated, at the time of deposit into the Reserve Account, in one of the three highest grades by (i) either Standard & Poor's Corporation or its successor, or Moody's Investors Service, Inc. or its successor or (ii) if both such corporations shall no longer perform the functions of a securities rating agency, a nationally recognized rating agency.

"Revenues" means all money received by the Authority in connection with or as a result of its ownership or operation of the System, including income derived from the sale of electricity generated or distributed by the System, any proceeds of use and occupancy insurance on the System or any part thereof and income from the

investment of moneys under the Trust Agreement, except income from the investment of moneys in the Construction Fund, the Reserve Maintenance Fund, the Capital Improvement Fund and the Subordinate Obligations Fund to the extent such income has been derived from the investment of moneys in such Fund to be used to pay Subordinate Obligations incurred to pay the cost of any work or properties which have not been included by the Authority as part of the System as provided in "Disposition of Revenues" below.

"Subordinate Obligations" means any obligations of the Authority incurred as provided in "Disposition of Revenues" below.

"SWAP agreement" means an agreement between the Authority and a SWAP party whereby the SWAP party agrees to pay to the Authority amounts calculated on the basis of all or a portion of the interest on Variable Rate Bonds at or prior to the times such interest is due and payable in consideration of the Authority's payment to the SWAP party of amounts set forth in the SWAP agreement.

"SWAP party" means a person who is party to a SWAP agreement and whose senior obligations are rated at the time of the execution and delivery of such SWAP agreement in one of the three highest rating categories (without regard to gradations within a category) by (i) Standard & Poor's Corporation or its successor and (ii) Moody's Investors Service or its successor.

"SWAP rate" means the fixed rate per annum on the principal amount of Variable Rate Bonds covered by a SWAP agreement equal to the percentage derived by dividing (i) the sum of the amounts in the last twelve months paid by the Authority in respect of interest on such bonds and to the SWAP party less the amount paid to the Authority by the SWAP party by (ii) such principal amount of Variable Rate Bonds; provided, however, that if such SWAP agreement has been in effect for less than twelve months, such percentage shall be multiplied by a fraction equal to 360 divided by the number of days between the effective date of such SWAP agreement and the date of calculation determined on the basis of 30-day months.

"System" means all the properties presently owned and operated by the Authority as a single integrated system, together with all works and properties which may be acquired or constructed by the Authority in connection with the production, distribution or sale of electric energy and the acquisition or construction of which shall be financed in whole or in part from the proceeds of bonds issued under the provisions of the Trust Agreement or from moneys deposited to the credit of the Construction Fund, the Capital Improvement Fund or from Subordinate Obligations to the extent such works and properties have been included by the Authority as part of the System as provided in "Disposition of Revenues" below.

"Time Deposits" means time deposits, certificates of deposit or similar arrangements with the Trustee, Government Development Bank for Puerto Rico or any bank or trust company which is a member of the Federal Deposit Insurance Corporation having a combined capital and surplus aggregating not less than \$100,000,000.

"Valuation Date" means with respect to any Capital Appreciation Bonds the date or dates set forth in the resolution authorizing such bonds on which Accreted Values are assigned to the Capital Appreciation Bonds.

"Variable Rate Bonds" means bonds issued with a variable, adjustable, convertible or similar interest rate which is not fixed in percentage at the date of issue for the term thereof but which may or may not be convertible to a fixed interest rate for the remainder of their term.

Provision for Variable Rate Bonds, Put Bonds, Extendible Maturity Bonds, Capital Appreciation Bonds and other types of bonds

Under the Trust Agreement, the Authority may issue Capital Appreciation Bonds, Variable Rate Bonds, Put Bonds, Extendible Maturity Bonds and other types of bonds which may from time to time be created. The interest rate calculation methods and interest rate payment dates, which need not be semi-annual, shall be established by the Authority prior to the issuance of particular Series of bonds. The features of Variable Rate Bonds shall be established prior to their issuance and may provide, in addition to provisions for conversion to a fixed interest rate, that bondholders may demand payment of principal and interest within a stated period. In this connection, the

Authority may provide for the remarketing of bonds that have been tendered pursuant to the demand features and for a credit facility or liquidity facility which may be drawn upon to make principal and interest payments on the Variable Rate Bonds. The terms for Put Bonds may contain some of the above provisions. The terms for Extendible Maturity Bonds may include an option to extend the maturity of such bonds granted to bondholders and the Authority. The terms for Capital Appreciation Bonds shall include Valuation Dates, the Accrued Value on such dates, the manner in which and the period during which principal and interest shall be deemed to accrue on said bonds and the amount of any deposit required for the Reserve Account. (Trust Agreement, Sections 208, 209 and 210).

Security for the Power Revenue Bonds

The Power Revenue Bonds are secured by a pledge from the Authority to the Trustee of the Revenues of the System and other moneys to the extent provided in the Trust Agreement as security for the payment of the Power Revenue Bonds and as security for the satisfaction of any other obligation assumed by it in connection with such Power Revenue Bonds. (Trust Agreement, Section 701).

The Power Revenue Bonds shall not be deemed to constitute a debt or obligation of the Commonwealth or any of its municipalities or other political subdivisions. (Trust Agreement, Section 701).

Issuance of Bonds Other than Refunding Bonds

The Trust Agreement provides for the issuance of Power Revenue Bonds for Improvements, including the repayment of advances therefor, to provide moneys for deposit to the Reserve Account in the Sinking Fund (the "Reserve Account") and for any proper corporate purpose of the Authority (other than for the purpose of refunding outstanding Power Revenue Bonds), subject to the conditions and limitations in the Trust Agreement. Power Revenue Bonds may be issued, if among other things:

(i) the Net Revenues for any 12 consecutive calendar months out of the 18 calendar months immediately preceding the date of the issuance of such bonds, adjusted to reflect the then current rate schedule, are not less than 120% of the maximum aggregate Principal and Interest Requirements for any fiscal year thereafter on account of all outstanding Power Revenue Bonds (excluding the bonds then to be issued), and

(ii) the estimated average annual Net Revenues for the five fiscal years immediately following the fiscal year in which the issuance of such bonds occurs, adjusted to reflect the then current rate schedule and any rate schedule the Authority has covenanted to put in effect during such five fiscal years, shall be not less than 120% of the maximum aggregate Principal and Interest Requirements for any fiscal year thereafter on account of all outstanding Power Revenue Bonds and the bonds then to be issued. (Trust Agreement, Sections 208 and 209).

Issuance of Refunding Bonds

The Trust Agreement provides for the issuance of Power Revenue Bonds to refund prior to or at their maturities all or any part of the outstanding bonds of any Series issued under the Trust Agreement, including the payment of any redemption premium, accrued interest and financing costs and for the purpose of providing moneys for deposit to the credit of the Reserve Account, subject to the conditions and limitations set forth therein. Power Revenue Refunding Bonds may be issued if, among other things, either (i) the earnings tests described above under the caption "Issuance of Bonds Other than Refunding Bonds" for the issuance of bonds under the Trust Agreement (except that effect is given to the retirement of the bonds to be refunded) are satisfied or (ii) the maximum aggregate Principal and Interest Requirements for any fiscal year thereafter on account of all outstanding Power Revenue Bonds and the bonds then to be issued (after giving effect to the retirement of the bonds to be refunded) shall be less than the maximum aggregate Principal and Interest Requirements on account of all outstanding Power Revenue Bonds (excluding the bonds then to be issued). Power Revenue Refunding Bonds may be issued without compliance with the foregoing tests to refund serial bonds of any Series of Power Revenue Bonds maturing within one year thereafter (and to pay interest thereon to maturity, if deemed necessary by the Authority), if the Authority

shall determine that the moneys in the Sinking Fund will not be sufficient for paying such serial bonds at their maturity. The proceeds of Power Revenue Refunding Bonds shall, to the extent practicable, be invested and reinvested by the Trustee, with the approval of the Executive Director, in Government Obligations, Prerefunded Municipal Bonds or in Time Deposits, secured in the manner set forth in the Trust Agreement, and the moneys so invested shall be available for use when required. (Trust Agreement, Section 210).

Funds and Accounts

General Fund

A special fund is created by the Trust Agreement and designated the "Puerto Rico Electric Power Authority General Fund" (the "General Fund"). The Authority covenants that all Revenues, other than income from investments made under the provisions of the Trust Agreement, will be deposited as received in the General Fund. The Authority covenants that moneys in the General Fund will be used first for the payment of Current Expenses of the System, and that, if the amount expended in any fiscal year for Current Expenses shall exceed the amount provided therefor in the Annual Budget, the Authority will report such excess and the reasons therefor to the Consulting Engineers and to the Trustee as soon as practicable but not later than the end of the sixth month following the month in which such excess shall have occurred. (Trust Agreement, Sections 503 and 505).

Revenue Fund

A special fund is created by the Trust Agreement and designated the "Puerto Rico Electric Power Authority Power Revenue Fund" (the "Revenue Fund"). The Treasurer of the Authority is required to transfer, on or before the 15th day of each month, from the General Fund to the Revenue Fund an amount equal to the amount of all moneys held in the General Fund at the end of the preceding month less an amount to be held as a reserve for Current Expenses as the Treasurer may determine, equal to not more than 1/6 of the amount shown by the Annual Budget to be necessary for Current Expenses for the current fiscal year, such transfer to be made on the books of the Authority as of the close of the preceding month. (Trust Agreement, Section 506).

Sinking Fund, Reserve Maintenance Fund, Self-insurance Fund, Capital Improvement Fund and Subordinate Obligations Fund

A special fund is created by the Trust Agreement and designated the "Puerto Rico Electric Power Authority Power Revenue Bonds Interest and Sinking Fund" (sometimes referred to in this Appendix I as the "Sinking Fund"). There are three separate accounts created in the Sinking Fund and designated the "Bond Service Account," "Reserve Account" and "Redemption Account." Four additional special funds are created by the Trust Agreement and designated the "Puerto Rico Electric Power Authority Reserve Maintenance Fund" (sometimes referred to in this Appendix I as the "Reserve Maintenance Fund"), the "Puerto Rico Electric Power Authority Self-insurance Fund" (sometimes referred to in this Appendix I as the "Self-insurance Fund"), the "Puerto Rico Electric Power Authority Capital Improvement Fund" (sometimes referred to in this Appendix I as the "Capital Improvement Fund") and the "Puerto Rico Electric Power Authority Subordinate Obligations Fund" (sometimes referred to in this Appendix I as the "Subordinate Obligations Fund"). (Trust Agreement, Section 507).

Disposition of Revenues

On or before the 25th day of each month, the Treasurer shall withdraw from the Revenue Fund, all the moneys then in such Fund (less any amount equal to the amount of Federal Subsidy Payments that have not been received as of the 25th of the month preceding the Interest Payment Date to which such Federal Subsidy Payments relate, which amount will be held in the Revenue Fund and (x) if the Federal Subsidy Payment has not been received by the Authority by such Interest Payment Date, transferred to the Bond Service Account on the Interest Payment Date or (y) if the Federal Subsidy Payment has been received by the Authority on or before such Interest Payment Date, remain on deposit in the Revenue Fund for application in accordance with the provisions below in the following calendar month) and deposit the moneys so withdrawn to the credit of the following Accounts and Funds in the following order:

1. the Bond Service Account until there has been deposited therein an amount equal to the sum of (i) the Interest Accrual on all the outstanding Power Revenue Bonds to and including the first day of the next calendar month, and (ii) the Principal Accrual on the outstanding serial bonds of each Series of outstanding Power Revenue Bonds to and including the first day of the next calendar month;

2. the Redemption Account, until there has been deposited therein an amount equal to the Amortization Accrual for the term bonds of each Series of Power Revenue Bonds then outstanding to and including the first day of the next calendar month;

3. the Reserve Account until the balance therein is equal to the interest payable on all outstanding Power Revenue Bonds within the next ensuing 12 months; provided, however, that the monthly deposit in respect of any Series of Power Revenue Bonds (other than refunding bonds) need not exceed 1/60 of the amount of the increase in the interest payable within the next ensuing 12 months resulting from the issuance of bonds of such Series, and provided, further, that the monthly requirements for deposits to the Reserve Account shall be cumulative; and that in the case of Variable Rate Bonds, the minimum amount to be deposited in the Reserve Account which shall be funded over the period required herein, shall be based initially on the interest rate in effect on the date of issuance of the Variable Rate Bonds and then shall be adjusted on the 25th day of each subsequent month based on the actual interest accrued from the 25th day of the previous month to the date of adjustment, except that in the case of Variable Rate Bonds in respect of which the Authority has notified the Trustee that a SWAP agreement is in effect, the Trustee shall use the SWAP rate in calculating the interest payable on such Bonds within the next ensuing twelve (12) months; that in the case of Capital Appreciation Bonds, the minimum amount required to be deposited in the Reserve Account shall be an amount derived from the interest rate which has been used to calculate the assumed yield on such bonds through their maturity times the Accreted Value of such bonds on the Valuation Date occurring at or after the first day of the twelfth succeeding month to the date of calculation of this requirement, as may be further specified in the resolution authorizing Capital Appreciation Bonds; and that in the case of Federally Subsidized Bonds, the amount of interest deemed to be payable on such Bonds from their date of issuance and for so long as the Trustee shall receive the scheduled amount of the Federal Subsidy Payments on or before such interest shall be payable shall exclude the amount of interest to be paid from the Federal Subsidy, but if the Trustee shall not receive the scheduled amount of the Federal Subsidy Payments on or before the date interest on such Federally Subsidized Bonds is payable or within thirty (30) of the date such Federal Subsidy Payments were scheduled to be received under the then current applicable law and regulations, then for purposes of the calculation of interest to be credited to the Reserve Account, the amount shall be equal to the interest payable on all Power Revenue Bonds within the next twelve (12) months;

4. the Reserve Maintenance Fund, such amount, if any, of any balance remaining after making the deposits described in paragraphs 1, 2 and 3 above (or the entire balance if less than the required amount) as may be recommended by the Consulting Engineers; provided that the monthly requirements for deposit to the Reserve Maintenance Fund shall be cumulative, and provided further that in the event that the Authority shall covenant in respect of any Subordinate Obligation to limit the monthly deposit to the Reserve Maintenance Fund as described in Subordinate Obligations Fund below, the monthly deposit required by this paragraph shall be equal to the least of

- (i) the amount described above in this paragraph,
- (ii) \$400,000, and
- (iii) an amount that when added to the amount then on deposit in the Reserve Maintenance Fund shall make the total amount on deposit equal to \$10,000,000;

5. one or more special accounts in the Subordinate Obligations Fund, such amount, if any, of any balance remaining after making the deposits described under paragraphs 1, 2, 3 and 4 above (or the entire balance if less than the required amount) that together with amounts then on deposit in the Subordinate Obligations Fund will make the total amount then on deposit equal to any amounts required to

be paid or accrued with respect to any Subordinate Obligations prior to the Deposit Day of the next succeeding month from or to the Subordinate Obligations Fund;

6. if the Authority shall have covenanted with respect to Subordinate Obligations to limit its deposit to the Reserve Maintenance Fund in accordance with the provisions of the second proviso of paragraph 4 above and in fact the deposit to said Fund pursuant to paragraph 4 was limited to the amount described in clause (ii) or (iii) of such paragraph, the Reserve Maintenance Fund, such amount of any balance remaining after making the deposits described under paragraphs 1, 2, 3, 4 or 5 above (or the entire balance if less than the required amount) as may be required to make the total amount deposited in the Reserve Maintenance Fund in such month equal to the amount described in clause (i) of clause (4) above;

7. the Self-insurance Fund, any balance remaining after making the deposits described in paragraphs 1, 2, 3, 4, 5 and 6 above as the Consulting Engineers shall from time to time recommend; and

8. the Capital Improvement Fund such amount of any balance remaining after making deposits described under paragraphs 1, 2, 3, 4, 5, 6 and 7 above as the Consulting Engineers shall from time to time recommend; provided that the monthly requirements for deposit to the Capital Improvement Fund shall be cumulative.

Any balance remaining after making the deposits under paragraphs 1 through 8 above may be used for any lawful purpose of the Authority. (Trust Agreement, Section 507).

If amounts applied to the payment of interest and principal on bonds are paid by a credit or liquidity facility issuer, the amounts deposited in the Bond Service Account allocable to said payment (other than a payment of the purchase price of bonds pursuant to a "put") may be paid to said credit or liquidity facility issuer. (Trust Agreement, Section 509).

Moneys in the Reserve Account shall be used by the Trustee first for the purpose of paying the interest on the Power Revenue Bonds and maturing principal of serial bonds whenever and to the extent moneys in the Bond Service Account are insufficient for such purposes and thereafter for the purpose of making the required deposits to the Redemption Account described in paragraph 2 above whenever the withdrawals from the Revenue Fund are insufficient for such purpose. Excess moneys in the Reserve Account shall be transferred to the Bond Service Account or may be used to reduce any Reserve Account Insurance Policy or Reserve Account Letter of Credit.

The Authority may deposit a Reserve Account Insurance Policy or Reserve Account Letter of Credit into the Reserve Account, in lieu, or in partial satisfaction, of any required deposit into the Reserve Account. Any reimbursement obligation in respect of a drawing under a Reserve Account Insurance Policy or Reserve Account Letter of Credit may be secured by a lien on Revenues not inconsistent with the provisions of the Trust Agreement and shall be payable or available to be drawn upon, as the case may be (upon the giving of notice as required thereunder), on any date on which moneys are required to be paid out of the Reserve Account pursuant to the Trust Agreement. If a disbursement is made under any Reserve Account Insurance Policy or Letter of Credit, the Authority shall be obligated either to reinstate the limits of such Reserve Account Insurance Policy or Reserve Account Letter of Credit following such disbursement or to deposit into the Reserve Account moneys, in accordance with the provisions of the Trust Agreement, in the amount of the disbursement made under such Reserve Account Insurance Policy or Reserve Account Letter of Credit. The Authority may at any time substitute (i) all or a portion of the moneys held to the credit of the Reserve Account with a Reserve Account Insurance Policy or Reserve Account Letter of Credit, (ii) all or a portion of any Reserve Account Insurance Policy on deposit in the Reserve Account with moneys or a Reserve Account Letter of Credit, or (iii) all or a portion of any Reserve Account Letter of Credit on deposit in the Reserve Account with moneys or a Reserve Account Insurance Policy. Any moneys on deposit in the Reserve Account in substitution of which a Reserve Account Insurance Policy or Reserve Account Letter of Credit is deposited shall, to the extent not required to fund any deficiencies in the amount then required to be on deposit in the Reserve Account, be released and immediately paid over to the Authority to be used by the Authority for any proper corporate purpose. Prior to the expiration date of any Reserve Account Insurance Policy or Reserve Account Letter of Credit then on deposit to the credit of the Reserve Account the Authority shall (x) cause the term of such Reserve Account Insurance Policy or Reserve Account Letter of Credit to be extended, (y) replace any such Reserve Account Insurance Policy with moneys (which may include, without limitation, moneys available under the

Reserve Account Insurance Policy or from any other source available for such purpose) or a Reserve Account Letter of Credit, or (z) replace any such Reserve Account Letter of Credit with moneys (which may include, without limitation, moneys available under the Reserve Account Letter of Credit or from any other source available for such purpose) or a Reserve Account Insurance Policy; provided that in the event that the Authority has not extended or replaced the expiring Reserve Account Insurance Policy or Reserve Account Letter of Credit by the fifth business day prior to its date of expiration, the expiring Reserve Account Insurance Policy or Reserve Account Letter of Credit shall, on such date, be drawn upon and the moneys so made available shall thereupon be deposited in the Reserve Account. (Trust Agreement, Section 510).

Moneys in the Reserve Maintenance Fund shall be used only for the purpose of paying the cost of unusual or extraordinary maintenance or repairs, maintenance or repairs not recurring annually and renewals and replacements, including major items of equipment. The Reserve Maintenance Fund also serves as an additional reserve for the payment of the principal of and the interest on the Power Revenue Bonds and meeting the Amortization Requirements to the extent that moneys in the Bond Service Account, Redemption Account and the Reserve Account are insufficient for such purpose. (Trust Agreement, Section 512).

Moneys in the Self-insurance Fund shall be used only for the purpose of paying the cost of repairing, replacing or reconstructing any property damaged or destroyed from, or extraordinary expenses incurred as a result of, a cause which is not covered by insurance required by the Trust Agreement. See "Insurance" below. The Self-insurance Fund also serves as an additional reserve for the payment of the principal of and the interest on the Power Revenue Bonds and meeting the Amortization Requirements to the extent that moneys in the Bond Service Account, Redemption Account and the Reserve Account and in the Reserve Maintenance Fund are insufficient for such purpose. (Trust Agreement, Section 512A).

Moneys in the Capital Improvement Fund shall be used only for the purpose of paying the cost of anticipated extensions and Improvements which cost has not otherwise been provided for from the proceeds of Power Revenue Bonds. The Capital Improvement Fund also serves as an additional reserve for the payment of principal of and the interest on Power Revenue Bonds and meeting the Amortization Requirements to the extent that moneys in the Bond Service Account, Redemption Account and the Reserve Account, in the Reserve Maintenance Fund and in the Self-insurance Fund are insufficient for such purpose. (Trust Agreement, Section 512B).

Subordinate Obligations Fund

Moneys in the Subordinate Obligations Fund shall be paid out or pledged by the Authority as necessary to enable the Authority to meet its Subordinate Obligations. Subordinate Obligations may be incurred or issued by the Authority for any proper corporate purpose of the Authority.

The Authority may covenant with the holders of any Subordinate Obligations to limit the deposits to the Reserve Maintenance Fund as authorized by paragraph 4 above and to add to the conditions, limitations and restrictions under which Power Revenue Bonds may be issued under the provisions of Trust Agreement.

Subordinate Obligations shall be payable out of and may be secured by a pledge of (i) available amounts in the Subordinate Obligations Fund and (ii) any other available funds of the Authority. Any such payment or pledge shall be expressly subordinate and junior in all respects to the lien and charge of the Power Revenue Bonds upon the Revenues.

Before incurring any Subordinate Obligations the proceeds of which shall be applied to acquire or construct any works or properties by the Authority in connection with the production, distribution or sale of electric energy, the Authority shall specify by resolution whether or not such works or properties are to be included as part of the System. (Trust Agreement, Section 516).

Construction Fund

The Trust Agreement creates a special fund designated the "Puerto Rico Electric Power Authority Power System Construction Fund" (the "Construction Fund"). The proceeds of any Power Revenue Bonds issued for the

purpose of paying the cost of Improvements, together with the moneys received from any other source for such purpose, except proceeds which are (i) applied to the repayment of advances, (ii) deposited in the Reserve Account, (iii) deposited in the Bond Service Account as capitalized interest or (iv) used for the payment of financing expenses, shall be deposited in the Construction Fund and held by the Authority in trust. (Trust Agreement, Sections 208 and 401).

Payments from the Construction Fund are made by the Executive Director or by any officer or employee of the Authority designated by him for such purpose. (Trust Agreement, Section 402).

Rate Covenant

The Authority covenants that it will at all times fix, charge and collect reasonable rates and charges for the use of the services and facilities furnished by the System so that the Revenues will be at all times sufficient to pay the Current Expenses of the System and to provide an amount at least equal to 120% of the aggregate Principal and Interest Requirements for the next fiscal year on account of all outstanding Power Revenue Bonds, reduced by any amount deposited in the Bond Service Account from the proceeds of bonds to pay interest to accrue thereon in such fiscal year.

The Authority further covenants that if at any time the Revenues shall not be sufficient to satisfy the foregoing covenant as to rates, it will revise the rates and charges for the services and facilities furnished by the System and, if necessary, it will revise its regulations in relation to the collection of bills for such services and facilities, so that such deficiency will be made up before the end of the next ensuing fiscal year. Should any deficiency not be made up in such next ensuing fiscal year, the requirement therefor shall be cumulative and the Authority shall continue to revise such rates until such deficiency shall have been completely made up. (Trust Agreement, Section 502).

Build America Bonds

With respect to Build America Bonds, the Authority covenants to file timely the necessary forms with the Internal Revenue Service so long as such filings are a condition to receipt of the Federal Subsidy prior to the date such interest shall be payable. The only effect of any failure to comply with this filing requirement shall be that the Federal Subsidy to which such failure relates shall no longer be excluded from the calculation of Principal and interest Requirements. (Trust Agreement, Section 713).

Investment of Funds

The Trust Agreement provides for the following types of investments:

- (a) Government Obligations;
- (b) Investment Obligations; and
- (c) Time Deposits.

Moneys in the Bond Service Account, the Redemption Account and the Revenue Fund shall be invested by the Trustee or by the Authority, as the case may be, in Government Obligations which shall mature, or which shall be subject to redemption by the holder thereof at the option of such holder, not later than the respective dates when such moneys will be required for the purposes intended, or in Time Deposits; provided, that each such Time Deposit shall permit the moneys so placed to be available for use when required for the purposes intended.

Any moneys in the Construction Fund, the Reserve Maintenance Fund, the Self-insurance Fund, the Capital Improvement Fund and the Reserve Account shall be invested by the Trustee or the Authority, as the case may be, in Investment Obligations which shall mature, or which shall be subject to redemption by the holder thereof at the option of such holder, in the case of the Construction Fund, the Self-insurance Fund, the Capital Improvement Fund and the Reserve Maintenance Fund, not later than the respective dates when the moneys invested will be required for

the purposes intended, and in the case of the Reserve Account, as to approximately 50% of such moneys, not later than five years after the date of such investment, and as to the balance of such moneys, as directed by order of the Executive Director or other authorized officer of the Authority. In lieu of such investments, moneys in the Construction Fund, the Reserve Maintenance Fund, the Self-insurance Fund, the Capital Improvement Fund and the Reserve Account may be invested in Time Deposits which shall permit the moneys so placed to be available for use at the times provided for investments in Investment Obligations. (Trust Agreement, Section 602).

Any moneys in the Self-insurance Fund may also be invested by the Authority in any investments authorized by law for the Retirement System of the Employees of the Government for Puerto Rico and its Instrumentalities, but the Authority shall invest not less than the smaller of \$25,000,000 and the entire balance in such Fund in Investment Obligations with an average weighted maturity of not more than three years.

Prior to investing any moneys in the Self-insurance Fund in other than Investment Obligations, the Authority shall obtain an Independent Consultant's report recommending what portion of moneys held in the Self-insurance Fund the Authority shall maintain invested in Investment Obligations and shall, after duly considering the report, formally adopt, subject to the consent of Government Development Bank for Puerto Rico, and maintain an investment policy first determining the minimum portion of the moneys held for the credit of the Self-insurance Fund to remain invested in Investment Obligations and then setting forth prudent investment principles, considerations and goals, including liquidity, diversification of assets, safety and rate or rates of return, that will govern the investment strategies and goals for the balance of the Self-insurance Fund and shall advise the Trustee in writing of those investments other than Investment Obligations that are authorized by said investment policy. (Trust Agreement, Section 602).

Accounting

The Authority covenants that it will keep accurate records and accounts according to standard practices for public utility systems similar to the properties and business of the Authority and applicable in such circumstances, of all items of cost and expenditures relating to the System, the Revenues collected and the application of the Revenues. The Authority further covenants that in the first month of each fiscal year it will cause an audit for the preceding fiscal year to be made of its books and accounts pertaining to the System by an independent firm of certified public accountants of suitable experience and responsibilities and widely known in the United States and approved by the Trustee. (Trust Agreement, Section 710).

Release of Property

The Authority covenants that so long as any Power Revenue Bonds shall be outstanding it will not sell, lease or otherwise dispose of or encumber the System or any part thereof and will not create or permit to be created any charge or lien on the Revenues ranking equally with or prior to the charge or lien on the Revenues of the Power Revenue Bonds. The Authority may, however, from time to time, sell machinery, fixtures, apparatus, tools, instruments or other movable property or materials if the Authority shall determine that such articles are no longer needed or useful in connection with the construction or operation and maintenance of the System. Any such moneys received may be applied to replace any such properties sold or disposed of or shall be deposited in the Redemption Account or the Construction Fund at the option of the Authority; provided that in connection with the issuance of bonds the Authority may secure its obligations to the provider of a credit or liquidity facility securing such bonds on a parity with the bonds. Other property forming part of the Systems, not needed or serving no useful purpose in connection with the System, may be sold, leased or transferred provided the proceeds of which shall be deposited in the Redemption Account or the Construction Fund and the rentals be deposited in the Revenue Fund.

Notwithstanding the previous paragraph, the Authority may abandon, sell, lease or transfer any property forming a part of the System, if, among other things, the Net Revenues for any 12 consecutive calendar months out of the 18 calendar months next preceding the date of such abandonment, sale, lease or transfer, adjusted to give effect to such abandonment, sale, lease or transfer and any replacement and to reflect the rate schedule then in effect, are not less than 120% of the maximum aggregate Principal and Interest Requirements for any fiscal year thereafter on account of all Power Revenue Bonds outstanding and if the Reserve Account is fully funded. Any transferee of said property may be considered in lieu of or in addition to the Authority for purposes of such coverage if, among other things, the transferee agrees to assume the Authority's obligations under the Trust Agreement. Said coverage

test need not be met if the transferee is a public corporation or other governmental entity provided the coverage is not reduced due to such transfer. The proceeds of such sale shall be deposited in the Redemption Account or in the Construction Fund, at the option of the Authority, or shall be applied to the replacement of the property so sold. The rentals under any such lease shall be deposited in the Revenue Fund.

In addition, the Authority may lease portions of the System or grant licenses, easements and other rights or make contracts or other arrangements for operation or use of the System, if certain reports and certificates of the Consulting Engineers are provided that confirm, among other things, that operational covenants will be binding on the lessee or other contracting entity and that the lease, contract, license, easement or other arrangement provides for rent or other payments that are projected to be sufficient with other projected Net Revenues of the System to make all payments of the Principal and Interest Requirements for all Power Revenue Bonds. Rents received under any such lease, contract, license, easement or other arrangement shall be deposited to the credit of the Revenue Fund. (Trust Agreement, Section 712).

Insurance

The Authority covenants that it will at all times carry insurance, in a responsible insurance company or companies authorized and qualified under the laws of Puerto Rico to assume the risk thereof, covering such properties belonging to the System as are customarily insured, and against loss or damage from such causes as are customarily insured against, by companies engaged in similar business.

The Authority covenants that, immediately after any loss or damage, it will cause to be prepared plans and specifications for repairing, replacing or reconstructing the damaged or destroyed property, and will forthwith proceed with the repair, replacement or reconstruction of the damaged or destroyed property unless it shall determine that the repair, replacement or reconstruction of such property is not essential to the efficient operation of the System. Proceeds of any insurance not applied within 18 months after receipt by the Treasurer to repairing, replacing or reconstruction damaged or destroyed property shall be deposited in the Redemption Account or, at the option of the Authority, the Construction Fund unless the Authority shall be prevented from doing so by conditions beyond its control or unless the holders of 51% in aggregate principal amount of the Power Revenue Bonds then outstanding shall otherwise direct. (Trust Agreement, Section 707).

Consulting Engineers and Independent Consultant

The Authority covenants that so long as any of the Power Revenue Bonds are outstanding it will employ as Consulting Engineers an independent engineer or engineering firm having a wide and favorable repute in the United States for skill and experience in the construction and operation of electric systems. It shall be the duty of the Consulting Engineers to prepare an annual report setting forth their recommendations as to any necessary or advisable revisions of rates and charges and such other advices and recommendations as they may deem desirable. It shall be the duty of the Consulting Engineers to include in such report their recommendations as to the amount to be deposited in the Reserve Maintenance Fund, the Capital Improvement Fund and the Self-insurance Fund. (Trust Agreement, Section 706).

The Authority covenants that so long as any Power Revenue Bonds are outstanding it will employ as Independent Consultant one or more independent firms having a wide and favorable repute in the United States for expertise in risk management and other insurance matters related to the construction and operation of electric systems. It shall be the duty of the Independent Consultant to prepare a report setting forth its recommendations, based on a review of the insurance then maintained by the Authority in accordance with the Trust Agreement and the status of the Self-insurance Fund, of any changes in coverage, including its recommendations of policy limits and deductibles and self-insurance, and investment strategies for the Self-insurance Fund. (Trust Agreement, Sections 706 and 707).

Modifications

The Authority and the Trustee may, without the consent of the holders of the Power Revenue Bonds, enter into such supplemental agreements as shall not be inconsistent with the Trust Agreement, (i) to cure any ambiguity,

to correct or supplement any provision in the Trust Agreement which may be inconsistent with any other provision therein, to make any other provisions which shall not be inconsistent with the provisions of the Trust Agreement, provided such action shall not adversely affect the interest of the bondholders, or (ii) to grant to or confer upon the Trustee for the benefit of the bondholders any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon the bondholders or the Trustee, or (iii) to add to the conditions, limitations and restrictions on the issuance of bonds under the provisions of the Trust Agreement other conditions, limitations and restrictions thereafter to be observed, or (iv) to add to the covenants and agreements of the Authority in the Trust Agreement other covenants and agreements thereafter to be observed by the Authority or to surrender any right or power reserved to or conferred upon the Authority by the Trust Agreement. (Trust Agreement, Section 1101).

The holders of not less than 60% in aggregate principal amount of the Power Revenue Bonds at the time outstanding shall have the right, from time to time (anything contained in the Trust Agreement to the contrary notwithstanding), to consent to and approve the execution by the Authority and the Trustee of such agreement or agreements supplemental to the Trust Agreement as shall be deemed necessary or desirable by the Authority for the purpose of modifying, altering, amending, adding to, repealing or rescinding, in any particular, any of the terms or provisions contained in the Trust Agreement or in any supplemental agreement; provided, however, that nothing contained in the Trust Agreement shall permit, or be construed as permitting, (a) an extension of the maturity of principal or interest on any Power Revenue Bond, or (b) a reduction in the principal amount of any Power Revenue Bond or the redemption premium or the rate of interest thereon, or (c) the creation of a lien upon or a pledge of the Revenues other than the lien and pledge created by the Trust Agreement, or (d) a preference or priority of any Power Revenue Bond or Bonds over any other Power Revenue Bond or Bonds, or (e) a reduction in the aggregate principal amount of the Power Revenue Bonds required for consent to such supplemental agreement. (Trust Agreement, Section 1102).

Events of Default and Remedies of Bondholders

Among the events described in the Trust Agreement as "events of default" are the following:

- (a) payment of the principal of and redemption premium, if any, on any of the Power Revenue Bonds shall not be made when the same shall become due and payable, or
- (b) payment of any installment of interest on any of the Power Revenue Bonds shall not be made when the same shall become due and payable, or
- (c) the Authority shall for any reason be rendered incapable of fulfilling its obligations under the Trust Agreement, or
- (d) the Authority shall default in the due and punctual performance of its other covenants, conditions, agreements and provisions contained in the Power Revenue Bonds or in the Trust Agreement, including meeting any Amortization Requirement, and such default shall continue for thirty (30) days after written notice shall have been given to the Authority by the Trustee which may give such notice in its discretion and shall give such notice at the written request of 10% in aggregate principal amount of the Power Revenue Bonds then outstanding, or
- (e) if notice has been received by the Trustee and the Authority from the bank or lending institution providing a credit or liquidity facility or other entity insuring, guaranteeing or providing for payments of principal or interest in respect of any Power Revenue Bonds that an event of default has occurred under the agreement underlying said facility or a failure of said bank or other financial or lending institution or other entity to make said facility available or to reinstate the interest component of said facility in accordance with its terms, to the extent said notice or failure is established as an event of default under the terms of the resolution authorizing the issuance of Power Revenue Bonds secured by the credit or liquidity facility). (Trust Agreement, Section 802)

In the event of any such default the Trustee may, and upon the written request of the holders of not less than 20% in aggregate principal amount of all Power Revenue Bonds then outstanding shall, declare the principal of the Power Revenue Bonds then outstanding to be due and payable, and, providing it shall be indemnified to its satisfaction, the Trustee may, and upon the written request of the holders of not less than 10% in aggregate principal amount of the Power Revenue Bonds then outstanding shall, proceed to protect and enforce its rights and the rights of the bondholders under the Trust Agreement by such suits, actions or special proceedings in equity or at law, or by such proceedings in the office of any board or officer having jurisdiction, either for the appointment of a receiver of the System as authorized by the Act or for the specific performance of any covenant or agreement or for the enforcement of any proper legal or equitable remedy, as the Trustee shall deem most effectual to protect and enforce the rights aforesaid; provided, however, that the Trustee shall not be required to proceed for the appointment of a receiver unless it shall have received the written request of the holders of not less than 25% in aggregate principal amount of such bonds then outstanding. (Trust Agreement, Sections 803, 804 and 902).

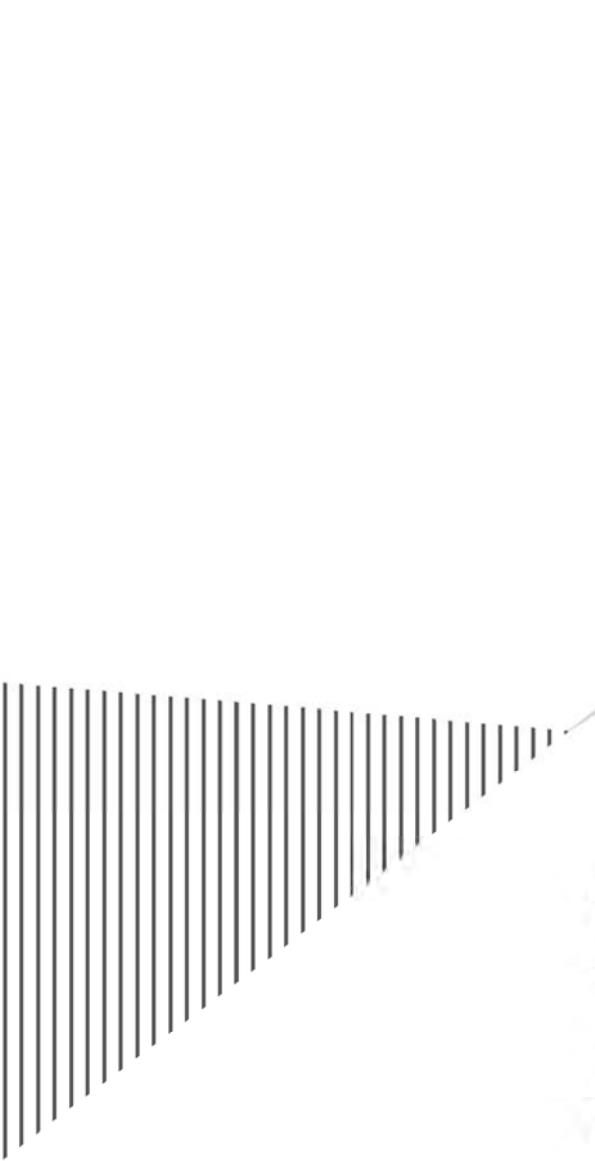
It is the intent of the Trust Agreement that all proceedings shall be instituted and maintained for the benefit of all holders of outstanding Power Revenue Bonds. (Trust Agreement, Section 809).

Defeasance

The Trust Agreement provides that if, when the Power Revenue Bonds shall have become due and payable or shall have been duly called for redemption or irrevocable instructions to call said bonds for redemption or payment shall have been given by the Authority to the Trustee, the whole amount of the principal and the interest and the premium, if any, so due and payable upon all of the Power Revenue Bonds then outstanding shall be paid or sufficient moneys, or Government Obligations or Prerefunded Municipalities or Time Deposits secured in the manner set forth in the Trust Agreement, the principal of and the interest on which when due will provide sufficient moneys, shall be held by the Trustee or the Paying Agents for such purpose under the provisions of the Trust Agreement, and provision shall be made for paying all other sums payable by the Authority, then and in that case the right, title and interest of the Trustee under the Trust Agreement shall cease, determine and become void, and the Trustee in such case, on demand of the Authority, shall release the Trust Agreement. For purposes of determining whether sufficient amounts have been deposited for defeasance, the interest to become due on Variable Rate Bonds shall be calculated at the maximum rate permitted by the terms thereof, and the principal, premium and interest to become due on Put Bonds and Extendible Maturity Bonds shall mean the maximum amount payable upon the exercise of put options by holders of said bonds or extensions of maturity by the holders of said bonds or the Authority. (Trust Agreement, Section 1201).

Bonds Not Deemed Outstanding

The Power Revenue Bonds and portions of Power Revenue Bonds which have been duly called for redemption pursuant to the Trust Agreement, or with respect to which irrevocable instructions to call for redemption or payment at or prior to maturity have been given to the Trustee in form satisfactory to it, and for the payment of principal or the redemption price and the accrued interest of which sufficient moneys, or Government Obligations or Prerefunded Municipalities or Time Deposits secured in the manner set forth in the Trust Agreement, shall be held in separate accounts by the Trustee or by the Paying Agents in trust for the holders of the bonds or portions thereof to be paid or redeemed, all as provided in the Trust Agreement, shall not thereafter be deemed to be outstanding under the provisions of the Trust Agreement. (Trust Agreement, Section 307).



FINANCIAL STATEMENTS, REQUIRED
SUPPLEMENTARY INFORMATION AND
SUPPLEMENTAL SCHEDULES

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)
Years Ended June 30, 2012 and 2011
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Financial Statements, Required Supplementary Information
and Supplemental Schedules

Years Ended June 30, 2012 and 2011

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Financial Section

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Report of Independent Auditors

To the Governing Board of the
Puerto Rico Electric Power Authority

We have audited the accompanying financial statements of the Puerto Rico Electric Power Authority (the Authority), a component unit of the Commonwealth of Puerto Rico, as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of PREPA Networks, Inc. (PREPA.Net) (a blended component unit), which financial statements reflect total assets constituting approximately .3% and .2% of total assets as of June 30, 2012 and 2011, and revenues constituting .2% of total revenues for the years then ended. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for PREPA Holdings and PREPA.Net, is based solely on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Authority's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report, dated June 3, 2013, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to



provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Accounting principles generally accepted in the United States require that management's discussion and the supplementary schedule of funding progress on pages 3 through 15 and 82 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Puerto Rico Electric Power Authority's financial statements. The supplemental schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Ernst & Young LLP

June 3, 2013

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this report.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis

Year Ended June 30, 2012

This section of the financial report of the Puerto Rico Electric Power Authority (the Authority) presents the analysis of the Authority's financial performance during the fiscal years ended June 30, 2012, 2011 and 2010. As management of the Authority, we offer readers of the financial statements this narrative overview and analysis of the financial activities. We recommend readers to consider the information herein presented in conjunction with the financial statements that follow this section.

Financial Highlights

- Operating income for fiscal year ended June 30, 2012 was \$257.0 million representing a decrease of 21.4 percent for the fiscal year ended June 30, 2011. For the fiscal year ended June 30, 2011 it was \$326.9 million representing a decrease of 6.1 percent for the fiscal year ended June 30, 2010.
- Operating expenses increased by \$693.4 million or 16.9 percent for the fiscal year ended June 30, 2012; and increased by \$272.7 million or 7.1 percent for the fiscal year ended June 30, 2011.
- The Authority's Net Utility Plant for the fiscal year ended June 30, 2012 decreased by \$13.4 million or .2 percent. For the fiscal year ended June 30, 2011 net utility plant increased by \$79.8 million or 1.2 percent. For the fiscal year ended 2010 the increase was \$129.2 million or 2.0 percent.
- Total assets and deferred outflows increased by \$321.5 million, increased by \$644.8 million and increased by \$208.6 million, or 3.2 percent increase, 6.9 percent increase and 2.3 percent increase, respectively, for the fiscal years ended June 30, 2012, 2011 and 2010.
- For the fiscal year ended June 30, 2012, as compared to the fiscal year ended June 30, 2011 and June 30, 2010, accounts receivable increased by 6.8 percent from \$1,277.9 million to \$1,364.6 million and increased by 17.8 percent from \$1,085.1 million to \$1,277.9 million, respectively. The increase in 2012 was mainly due to an increase in fuel adjustment revenues.
- Accounts receivable from the governmental sector decreased 7.5 percent from \$464.1 million on June 30, 2011 to \$429.2 million on June 30, 2012, and increased 34.3 percent from \$345.5 million on June 30, 2010 to \$464.1 million on June 30, 2011.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

Financial Highlights (continued)

- The Authority's net assets decreased by \$346.2 million (200.4 percent), \$272.4 million (264.7 percent) and \$129.7 million (55.8 percent) as a result of operations during fiscal years ended June 30, 2012, 2011 and 2010, respectively. As of June 30, 2012, the Authority is in a net deficit position.
- Ratios of fuel and purchased power adjustment revenues to total operating revenues were 78.6 percent for 2011-2012, 75.0 percent for 2010-2011 and 72.7 percent for 2009-2010.
- Ratios of fuel oil and purchased power expense to total operating expense (excluding depreciation expense) were 82.0 percent for 2011-2012, 78.8 percent for 2010-2011 and 77.9 percent for 2009-2010.
- The increase in the fuel adjustment revenues and fuel expense for fiscal year 2012 as compared to 2011 of \$606.2 million and \$610.5 million, respectively, was mainly due to an increase in the average fuel oil price per barrel of \$22.48 (23.4%). The increase in the fuel adjustment revenues and fuel expense for fiscal year 2011 as compared to 2010 of \$322.9 million and \$284.5 million, respectively, was mainly due to an increase in the average fuel oil price per barrel of \$19.36 (25.3%). In addition, the increase in the fuel adjustment revenues and fuel expense for fiscal year 2010 as compared to 2009 of 94.4 million and 87.1 million, respectively, was mainly due to an increase in the average fuel oil price per barrel of \$0.32 (0.4%).
- The increase in the purchased power adjustment revenue and expense of \$26.3 million and \$23.2 million, respectively, was due to an increase in the average cost per kwh of (1.1%) purchase power from 10 cents for fiscal 2011 to 11 cents (1.10%) for fiscal 2012. The increase in the purchased power adjustment revenue and expense of \$37.3 million and \$32.8 million, respectively, was due to a decrease of 179,662 MWh (or 2.6 percent) purchase power for fiscal 2011 when compared to fiscal 2010. The increase in the purchased power adjustment revenue and expense of \$24.9 million and \$21.9 million, respectively, was due to an increase of 234,159 MWh (or 3.6 percent) purchase power for fiscal 2010 when compared to fiscal 2009.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

Plans to Address the Authority's Challenges

The Authority faced a number of business challenges that have been exacerbated by the Commonwealth's economic recession and the volatility in oil prices. Its principal challenges, some of which are interrelated, are: (i) addressing the decline in electric energy sales; (ii) addressing the volatility of oil costs; (iii) addressing high customer electric power rates; (iv) reducing government accounts receivables; and (v) improving its liquidity.

The Authority's management focused on addressing these challenges by implementing a financial stabilization plan and other strategic initiatives. The principal component of the financial stabilization plan was the reduction of operating costs in line with the reduction in electric energy sales in order to maintain adequate operating margins.

The principal cost reduction measures included in the plan are (i) reducing the number of employees through a combination of attrition from voluntary retirement and the elimination of temporary and vacant positions, (ii) reducing retiree health care benefits, and (iii) reducing overtime and miscellaneous expenses. The Authority has already implemented measures that are expected to result in recurring annual savings consisting of (i) a reduction of employees from January 1, 2011 through June 30, 2012, (ii) changes to retiree health care benefits and (iii) other cost reduction initiatives, such as the reduction of overtime and miscellaneous expenses, that are expected to result in annual savings of approximately \$30 million.

Customer Care and Billing Project

On March 2012 the Authority implemented a new Customer Service System, which will be capable of providing detailed information on PREPA's wide customer base, as well as serving as the energy sales Accounts Receivable Subsidiary Ledger. In addition, the Customer Care and Billing System (CC&B) improved the quality of this important information and enhance the financial analysis currently performed using a variety of tools. It is part of the Authority's commitment to use technology to improve customer services quality, financial performance and operational efficiency.

Overview of Financial Report

Management's Discussion and Analysis (MD&A) of operating results serves as an introduction to the basic financial statements and supplementary information. Summary financial statement data, key financial and operational indicators used in the Authority's strategic plan, projected capital improvement program, operational budget and other management tools were used for this analysis.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

Required Financial Statements

The financial statements report the financial position and operations of Puerto Rico Electric Power Authority and its blended component units, Puerto Rico Irrigation Systems and PREPA Holdings LLC as of and for the year ended June 30, 2012, which include a Balance Sheet, Statement of Revenues, Expenses and Changes in Net Assets, Statement of Cash Flows and the notes to financial statements.

PREPA Networks, Corp. issued a separate financial report that includes audited financial statements. That report may be obtained by writing to PREPA Networks, Corp. City View Plaza Suite 803, Guaynabo, Puerto Rico 00968.

The Balance Sheet presents the financial position of the Authority and provides information about the nature and amount of resources and obligations at year-end.

The Statement of Revenues, Expenses and Changes in Net Assets presents the results of the business activities over the course of the fiscal year and information as to how the net assets changed during the fiscal year.

The Statement of Cash Flows shows changes in cash and cash equivalents, resulting from operating, non-capital and capital financing, and investing activities, which include cash receipts and cash disbursement information, without consideration of the depreciation of capital assets.

The notes to the financial statements provide information required and necessary to the understanding of material information of the Authority's financial statements. These notes present information about the Authority's significant accounting policies, significant account balances and activities, risk management, obligations, commitments and contingencies, and subsequent events.

The financial statements were prepared by the Authority's management from the detail accounting books and records.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

Financial Analysis

The Authority's net assets decreased by \$346.2 million for the fiscal year ended June 30, 2012 and decreased by \$272.4 million and \$129.7 million for the fiscal years ended June 30, 2011 and 2010, respectively. Our analysis below focuses on the Authority's net assets and changes in net assets during the year.

Authority's Net Assets
(In thousands)

	2012	2011	2010
	<i>(As restated)</i>		
Current, non-current and other assets	\$ 3,454,676	\$ 3,119,743	\$ 2,554,764
Capital assets	6,799,176	6,812,602	6,732,790
Total assets	\$10,253,852	\$ 9,932,345	\$ 9,287,554
Long-term debt outstanding	\$ 8,330,283	\$ 7,895,288	\$ 7,572,024
Other liabilities	2,439,255	2,206,552	1,612,597
Total liabilities	\$10,769,538	\$10,101,840	\$ 9,184,621
Net assets (deficit):			
Invested in capital assets, net of related debt	\$ 38,122	\$ 17,070	\$ 161,389
Restricted	18,299	77,606	136,053
Unrestricted	(572,107)	(264,171)	(194,509)
Total net assets (deficit)	\$ (515,686)	\$ (169,495)	\$ 102,933

A significant portion of the Authority's net assets (deficit) is restricted and represents resources that are subject to external restrictions on how they may be used. An additional portion of the Authority's net assets reflects its investment in capital assets, less any related debt used to acquire those assets that is still outstanding.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

Financial Analysis (continued)

Net assets invested in utility plant, net of related debt increased from \$17.1 million in 2010-2011 to \$38.1 million in 2011-2012, mainly due to the amortization of debt issued to finance construction at a higher pace than the depreciation of utility plant.

Restricted net assets (deficit) for capital and debt service requirements decreased from 77.6 million as of June 30, 2011 to \$18.3 million as of June 30, 2012. The decrease was mainly due to an increase on outstanding Power Revenue Bonds, which a portion was deposited on the reserve account. As allowed by the 1974 Trust Agreement, cash reserves in excess of required balances were transferred to debt service accounts.

Changes in the Authority's net assets can be determined by reviewing the following condensed Statements of Revenues, Expenses and Changes in Net Assets.

Authority's Changes in Net Assets

(In thousands)

	Year Ended June 30		
	2012	2011	2010
Operating revenues	\$5,046,494	\$4,422,997	\$4,171,493
Other income	24,344	4,087	11,160
Total revenues	5,070,838	4,427,084	4,182,653
Operating expenses	4,789,469	4,096,080	3,823,396
Interest expense, net	381,943	370,251	346,653
Total expenses	5,171,412	4,466,331	4,170,049
(Loss) income before contribution in lieu of taxes and other and contributed capital	(100,574)	(39,247)	12,604
Contribution in lieu of taxes and other	(283,111)	(246,758)	(232,431)
Loss before contributed capital	(383,685)	(286,005)	(219,827)
Contributed capital	\$37,494	13,577	90,121
Change in net assets	(346,191)	(272,428)	(129,706)
Net assets at beginning of year	(169,495)	102,933	232,639
Net assets at end of year	\$ (515,686)	\$ (169,495)	\$ 102,933

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

Financial Analysis (continued)

For fiscal year ended June 30, 2012, as compared to June 30, 2011, net assets decreased by \$346.2 million. The reduction in net assets was mainly due to a combination of factors that include, among others, an increase in operating revenue of \$623.5 million and operating expenses of \$693.4 million, as a result, there was a decrease in operating income of \$69.9 million, mainly due to an increase of fuel oil price and an increase in depreciation expenses of \$63.9 million, as well as increases in interest expense, and contribution in lieu of taxes. In addition, the Authority's net assets were reduced by \$79.4 million in fuel adjustment revenues not billed to the customers, which were financed by the revenue stabilization fund and \$37.2 million of costs related to the abandoned Via Verde Project (Natural Gas Pipeline Project), which were registered as operating expenses.

The Authority's management has taken the following expense control measures:

The Authority reduced the number of employees through a combination of attrition from voluntary retirement and the elimination of temporary and vacant positions. In addition, the Authority is still enforcing the new staff hiring freeze implemented in January 2009.

The Authority's management has also identified the following strategies to stabilize the cost of energy:

- Revenue diversification – Net income generated from two recently created subsidiaries will be used to find a revenue stabilization fund to reduce fuel price volatility.
- Fuel diversification – The Authority is in the process of converting generating units that use fuel oil to convert to burn natural gas in order to comply with new environmental regulations. In addition, the Authority has begun negotiations for the construction of an offshore gas port to receive natural gas at the south part of the island in Aguirre Steam Plant.
- Reducing energy theft – The Authority has implemented an energy theft reduction program through the use of smart grid technologies and increasing the unannounced door-to-door visits.

For fiscal year ended June 30, 2011, as compared to June 30, 2010, net assets decreased by \$272.4 million. The reduction in net assets was mainly due to an increase in operating expenses of \$272.7 million, mainly due to an increase of \$284.5 net of a decrease of \$4.7 million in the fuel expenses and depreciation expenses, respectively, as well as increases in interest expense and contribution in lieu of taxes.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

Financial Analysis (continued)

For fiscal year ended June 30, 2010, as compared to June 30, 2009, net assets decreased by \$129.7 million. The reduction in net assets was mainly due to an increase in operating expenses of \$172.9 million, mainly due to increases of \$38.9 million and \$37.8 million in the administrative and general and depreciation expenses, respectively, as well an increase in interest expense and contribution in lieu of taxes.

Capital Assets and Debt Administration

Capital Assets

The Authority's capital assets were restated during fiscal 2010 in order to account for prior years contributed capital which was not accounted for. The total amount of the restatement was \$206,549 and was divided as follows (in thousands):

	2010	2009
Capital assets	\$13,129	\$193,420

Investment in capital assets as of June 30, 2012, 2011 and 2010, amounts to approximately \$6,799 million, \$6,813 million, and \$6,733 million (net of accumulated depreciation), respectively. This investment in capital assets includes land, generation, transmission and distribution systems, buildings, fixed equipment, furniture, fixtures and equipment. The total increases in the Authority's investment in capital assets (net of accumulated depreciation) were decrease by .2 percent, increased by 1.2 percent and increased by 2.0 percent for 2011-2012, 2010-2011, and 2009-2010, respectively.

A substantial portion of the capital expenditures for production plant in fiscal year ended June 30, 2012, 2011 and 2010, was spent on the rehabilitation and life extension of generating plants in order to achieve and maintain higher levels of availability, reliability and efficiency.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

Capital Assets and Debt Administration (continued)

Capital Assets (continued)

Major capital assets projects during fiscal years 2011 and 2012 included the following:

- The Authority replaced the four 21 MW combustion turbines with new four 55MW dual fuel aero-derivative combustion turbines, which represent a net increase in capacity of approximately 136 MW over the replaced combustion turbines and they will generate electricity more efficiently. The first two combustion turbines were installed in fiscal year 2010 and the remaining two were installed and in service on fiscal year 2011.
- The Authority completed the conversion of units 5 and 6 at the Costa Sur Power Plant to dual fuel, representing approximately 820 MW of generating capacity. Improvements to boiler's internal components to burn 100% of natural gas have been completed for unit 6 and are in progress for unit 5.
- The Authority is currently working in the conversion of units 1 and 2 at the Aguirre Power Plant to dual fuel, representing approximately 900 MW of generating capacity. Improvements include the evaluation of future retrofits to boiler's internal components to burn 100% of natural gas.
- The Authority has ordered the dual-fuel modules for the conversion of units 5 and 6 at the San Juan Power Plant to burn natural gas. This project represents approximately 460 MW of generating capacity.
- The Authority is working with the regular scheduled maintenance of its steam unit fleet. Boilers and turbine-generators are included in this comprehensive maintenance program.
- The Authority is also working with the regular scheduled maintenance of its combustion turbine fleet. Cambalache and San Juan units 5 and 6 are the key facilities included in this comprehensive maintenance program.
- The Authority has important projects for the supply of water for industrial processes and generation. The new demineralized water plant at Costa Sur Power Plant, as well as Aguirre Power Plant water supply project are examples of key capital improvements focused on reliability and natural resources protection.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

Capital Assets and Debt Administration (continued)

Capital Assets (continued)

- The Authority repaired steam turbines generator and replaced transformers and major electrical equipment of Palo Seco steam units, which have 85 MW capacities. In addition, the Authority replaced the control room for all the units and switchgear for Palo Seco Steam Plant units two, three and four. The total cost of repairing the Palo Seco Steam Plant was approximately \$125 million.
- The Authority is now constructing a 230 kV transmission line (38 mile long) between the South Coast Steam Plant and Cambalache Gas Turbines Plant's switchyard. The first stage of this project consists of the reconstruction and conversion to 230 kV of an existing 115 kV circuit line between the South Coast Steam Plant and Dos Bocas Hydroelectric Power Plant. The second stage of the project consists of the construction of a new 230 kV line from Dos Bocas to the Cambalache facilities. The construction of both stages is expected to be completed during fiscal year 2013. The estimated cost of this project is \$80 million.
- The program to improve the 38 kV sub-transmission systems continues in effect, including the construction of underground 38 kV lines in Guaynabo and San Juan. In addition, major reconstruction projects of aerial 38 kV lines in the central and western part of the Island will significantly improve the reliability of the sub-transmission system.
- The Authority completed an underground 115 kV transmission circuit line around the San Juan metropolitan area in order to reduce the incidence of loss of power in the aftermath of hurricanes and other major storms, which strike Puerto Rico from time to time. This project is presently improving the reliability of its transmission system in San Juan by interconnecting two steam plants, three existing transmission centers, and four new 115 kV gas insulated substations (GIS) through a 30-mile underground loop of 115 kV. The cost of this project was \$200 million. The Federal Emergency Management Agency provided \$75 million for of construction for this project through grants to the Authority.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

Capital Assets and Debt Administration (continued)

Capital Assets (continued)

- Martin Peña GIS is a new gas insulated 115/38 kV transmission center with a 300 MVA installed transforming capacity. Palo Seco GIS, one of PREPA's major gas insulated 115/38 kV switchyards with direct interconnection to 600 MW of generating capability, was energized during fiscal year 2009 at a cost of \$66 million. San Juan GIS, one of PREPA's major gas insulated 115/38 kV switchyards with direct interconnection through the existing air insulated 115kV bus to approximately more than 850 MW of generating capability, is expected to be in service during fiscal year 2016.
- Two major expansion projects to add 300 MVA of 115/38 kV transforming capacity in the transmission centers of Aguadilla and Ponce were completed and energized between fiscal year 2010 and the beginning of fiscal year 2011. A major expansion project that add 150 MVA of 115/38 kV transforming capacity in the Canóvanas TC was completed in 2012. A new air insulated 38 kV switchyard in the municipality of Aguadilla also started operating during fiscal year 2010. A new 150 MVA 115/38 kV transmission center in the municipality of Bayamón (Hato Tejas TC) is expected to complete in 2013. A new 450 MVA 230/115 kV transmission center in Ponce TC was completed during fiscal year 2012.
- A new 115 kV capacitor bank is in operation from 2012 in Canóvanas TC.
- The following projects are expected to be in construction for the next five years: a new 230 kV line between Aguirre steam plant and Cayey, the new 230 kV line between Costa Sur Steam Plant and Aguas Buenas, and the new transmission centers below: Venezuela TC in Río Piedras, Bairoa TC in Caguas, and Las Cruces TC in Cidra, to add 400 MVA of 115/38 kV transforming capacity.

These projects are funded from cash reserves, excess-operating revenues (when available), grants, and debt issued for such purposes.

Additional information on the Authority's capital assets can be found in Note 6 to the financial statements.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

Capital Assets and Debt Administration (continued)

Long-Term Debt

At the end of the fiscal year 2012, 2011 and 2010, the Authority had total long-term debt outstanding of \$8,935.5 million, \$8,089.0 million and \$7,587.1 million, respectively, comprised of revenue bonds and other borrowings.

Authority's Outstanding Debt
(*In thousands*)

	2012	2011	2010
Power revenue bonds, net	\$8,311,689	\$ 7,861,252	\$ 7,495,322
Notes payable	623,813	227,736	91,792
	8,935,502	8,088,988	7,587,114
Current portion	(985,194)	(552,252)	(187,368)
Long-term debt, excluding current portion	\$7,950,308	\$ 7,536,736	\$ 7,399,746

During fiscal year 2012, notes payable increased \$400 million mainly as a result of new revolving lines of credit to finance working capital.

The Authority maintains ratings of "Baa2" by Moody's, and "BBB+" by S&P and "BBB+" by Fitch for its bonds.

Additional information on the Authority's long-term debt can be found in Notes 8 and 11 to the financial statements.

Economic Factors and Next Year's Budgets and Rates

In the last five years, Puerto Rico's economy has shown a different behavior from US economy in terms of the annual Gross Domestic Product growth, even though Puerto Rico is part of the US monetary and banking systems. The US economy, measured by the Real Gross Domestic Product (GDP), increased 1.8% in calendar year 2011. In the second and third quarter of 2012, real GDP increased 1.3% and 3.1%, respectively.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

Economic Factors and Next Year's Budgets and Rates (continued)

For the fiscal year 2011, the economy of Puerto Rico measured by the Gross National Product, preliminarily decreased 1.5%, according to the Puerto Rico Planning Board. The main components of the PR economy are: manufacturing (approximately 40% of the GNP), finance, insurance and the real estate, trade and service sectors.

For the fiscal year 2012, the PR Planning Board estimated an increase of .9%, according to their last forecast of April 2012.

The Authority adopted the 2013 fiscal year budget on June 29, 2012. The total revenues for fiscal year 2012-2013 are projected to be approximately \$ 4,866.7 million. In addition, the Capital Improvement Program amounted to approximately \$300.0 million. The 2013 consolidated budget decreased by \$61.3 million (1.2 percent) when compared to the consolidated budget approved for fiscal year 2011-2012, due mainly to a decrease on projected fuel oil price per barrel from \$117.10 fro 2011-2012 to \$116.25 for 2012-2013, representing a 26.5 percent. In addition, the Capital Improvement Program increased by \$26.5 million, representing a 8.1 percent.

Request for Information

This financial report is designed to provide a general overview of the Authority's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Authority's Chief Financial Officer. The executive offices of the Authority are located at 1110 Ponce de León Avenue, San Juan, Puerto Rico 00907.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Balance Sheets
(*In thousands*)

	June 30	
	2012	2011
Assets and deferred outflows		
Current assets:		
Cash and cash equivalents	\$ 199,761	\$ 64,856
Receivables, net	1,259,782	1,182,468
Fuel oil, at average cost	228,681	228,007
Materials and supplies, at average cost	194,387	196,649
Prepayments and other assets	55	—
Total current assets	<u>1,882,666</u>	1,671,980
Other non-current receivables	104,780	95,407
Restricted assets:		
Cash and cash equivalents held by trustee for payment of principal and interest on bonds	337,506	313,531
Investments held by trustee	636,635	616,506
Construction fund and other special funds	296,669	244,444
Total restricted assets	<u>1,270,810</u>	1,174,481
Utility plant:		
Plant in service	11,703,301	11,156,611
Accumulated depreciation	<u>(5,768,095)</u>	(5,364,446)
	5,935,206	5,792,165
Construction in progress	863,970	1,020,437
Total utility plant, net	<u>6,799,176</u>	6,812,602
Deferred expenses:		
Unamortized debt issue costs	59,437	60,961
Deferred outflows	111,307	69,142
Other	25,676	47,772
Total deferred expenses	<u>196,420</u>	177,875
Total assets and deferred outflows	<u>\$ 10,253,852</u>	\$ 9,932,345

(Continued)

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Balance Sheets (continued)
(*In thousands*)

	June 30	
	2012	2011
Liabilities and net assets		
Current liabilities:		
Notes payable	\$ 605,219	\$ 193,700
Accounts payable and accrued liabilities	1,038,663	1,251,690
Customers' deposits	49,780	39,505
Total current liabilities	<u>1,693,662</u>	1,484,895
Current liabilities payable from restricted assets:		
Current portion of long-term debt and bond anticipation notes	379,975	358,552
Accrued interest	185,757	183,314
Other current liabilities payable from restricted assets	51,546	69,408
Total current liabilities payable from restricted assets	<u>617,278</u>	611,274
Noncurrent liabilities:		
Long-term debt, excluding current portion	7,950,308	7,536,736
Fair value of derivative instruments	111,307	69,142
Customers' deposits (excluding current portion)	126,367	136,274
Sick leave benefits to be liquidated after one year	139,904	139,903
Accrued unfunded other post-employment benefits liability	130,712	123,616
Total noncurrent liabilities	<u>8,458,598</u>	8,005,671
Total liabilities	<u>10,769,538</u>	10,101,840
Net assets (deficit):		
Invested in utility plant, net of related debt	38,122	17,070
Restricted for capital activity and debt service	18,299	77,606
Unrestricted	<u>(572,107)</u>	(264,171)
Total net assets (deficit)	<u>(515,686)</u>	(169,495)
Total liabilities and net assets	<u><u>\$ 10,253,852</u></u>	\$ 9,932,345

See accompanying notes.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Statements of Revenues, Expenses and Changes in Net Assets
(*In thousands*)

	Year Ended June 30	
	2012	2011
Operating revenues	\$ 5,046,494	\$ 4,422,997
Operating expenses:		
Operations:		
Fuel	2,901,815	2,291,386
Purchased power	684,148	660,871
Other production	78,311	68,931
Transmission and distribution	178,652	179,002
Customer accounting and collection	113,647	114,995
Administrative and general	201,228	205,586
Maintenance	217,095	224,612
Depreciation	414,573	350,697
Total operating expenses	<u>4,789,469</u>	<u>4,096,080</u>
Operating income	257,025	326,917
Interest income and other	24,344	4,087
Income before interest charges, contribution in lieu of taxes and contributed capital	281,369	331,004
Interest charges:		
Interest on bonds	382,604	378,343
Interest on notes payable and other long-term debt	4,720	1,882
Amortization of debt discount, issuance costs and refunding loss	6,331	6,497
Allowance for funds used during construction	(11,712)	(16,471)
Total interest charges, net	<u>381,943</u>	<u>370,251</u>
Loss before contribution in lieu of taxes and contributed capital	<u>(100,574)</u>	<u>(39,247)</u>
Contribution in lieu of taxes and other	(283,111)	(246,758)
Loss before contributed capital	<u>(383,685)</u>	<u>(286,005)</u>
Contributed capital	37,494	13,577
Change in net assets	<u>(346,191)</u>	<u>(272,428)</u>
Net assets, beginning balance	(169,495)	102,933
Net assets (deficit), ending balance	<u>\$ (515,686)</u>	<u>\$ (169,495)</u>

See accompanying notes.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Statements of Cash Flows
(In thousands)

	Year Ended June 30	
	2012	2011
Cash flows from operating activities		
Cash received from customers	\$ 4,954,920	\$ 4,203,889
Cash paid to suppliers and employees	(4,871,027)	(3,675,557)
Net cash flows provided by operating activities	<u>83,893</u>	<u>528,332</u>
Cash flows from noncapital financing activities		
Proceeds from notes payable	266,623	172,062
Principal paid on notes payable	(383,988)	(36,119)
Interest paid on notes payable	(4,924)	(28,286)
Principal paid on fuel line of credit	(60,000)	(125,000)
Proceeds from fuel line of credit	599,995	125,000
Interest paid on fuel line of credit	(6,039)	(3,100)
Net cash flows provided by noncapital financing activities	<u>411,667</u>	<u>104,557</u>
Cash flows from capital and related financing activities		
Construction expenditures	(370,949)	(423,872)
Proceeds received from contributed capital	7,291	6,064
Allowance for funds used during construction	11,712	16,471
Power revenue bonds:		
Proceeds from issuance of bonds, net of original discount	623,421	361,620
Principal paid on revenue bonds maturities	(175,455)	–
Interest paid on revenue bonds	(379,991)	(209,287)
Proceeds from issuance of refunding bonds, net of original discount	21,828	222,883
Defeased bonds, net of original discount or premium	(21,844)	(200,173)
Proceeds from bond anticipation notes	–	50,750
Payment of bond anticipation notes	–	(50,000)
Interest paid on notes payable	–	(201)
Net cash flows used in capital and related financing activities	<u>(283,987)</u>	<u>(225,745)</u>
Cash flows from investing activities		
Purchases of investment securities	(4,907,026)	(3,260,411)
Proceeds from sale and maturities of investment securities	4,880,263	3,042,316
Interest on investments	24,661	4,860
Transfer from general fund to restricted funds	(5,000)	(15,000)
Net cash flows used in investing activities	<u>(7,102)</u>	<u>(228,235)</u>
Net increase in cash and cash equivalents	<u>204,471</u>	<u>178,909</u>
Cash and cash equivalents at beginning of year	610,553	431,644
Cash and cash equivalents at end of year	<u>\$ 815,024</u>	<u>\$ 610,553</u>

(Continued)

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Statements of Cash Flows
(In thousands)

	Year Ended June 30	
	2012	2011
Cash and cash equivalents		
Unrestricted	\$ 199,761	\$ 64,856
Restricted:		
Cash and cash equivalents held by trustee for payment of principal and interest on bonds	337,506	313,531
Cash and cash equivalents within construction and other special funds	<u>277,757</u>	<u>232,166</u>
	<u><u>\$ 815,024</u></u>	<u><u>\$ 610,553</u></u>

	Year Ended June 30	
	2012	2011
Reconciliation of net operating revenues to net cash provided by operating activities		
Operating income	\$ 257,025	\$ 326,917
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	414,573	350,697
Provision for uncollectible accounts and other	<u>14,428</u>	<u>30,109</u>
Changes in assets and liabilities:		
Receivables	(310,148)	(313,141)
Fuel oil	(674)	(42,714)
Materials and supplies	2,304	(17,738)
Prepayments and other assets	3,309	3,364
Other deferred debits	<u>23,620</u>	<u>47,522</u>
Noncurrent liabilities, excluding revenue bonds and notes payable	7,097	37,680
Accounts payable and accrued liabilities	<u>(328,009)</u>	<u>104,642</u>
Customer's deposits	368	994
Total adjustments	<u><u>(173,132)</u></u>	<u><u>201,415</u></u>
Net cash flows provided by operating activities	<u><u>\$ 83,893</u></u>	<u><u>\$ 528,332</u></u>

See accompanying notes.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements

June 30, 2012

1. Reporting Entity

Puerto Rico Electric Power Authority (the Authority) is a public corporation and governmental instrumentality of the Commonwealth of Puerto Rico (the Commonwealth) created on May 2, 1941, pursuant to Act No. 83, as amended, re-enacted, and supplemented, of the Legislature of Puerto Rico (the Act) for the purpose of conserving, developing and utilizing the water, and power resources of Puerto Rico in order to promote the general welfare of the Commonwealth. Under the entity concept, the Authority is a component unit of the Commonwealth. The Authority produces, transmits, and distributes, substantially, all of the electric power consumed in Puerto Rico.

The Authority has broad powers including, among others, to issue bonds for any of its corporate purposes. The Authority is required, under the terms of a Trust Agreement dated as of January 1, 1974, as amended (the 1974 Agreement), and the Act, to determine and collect reasonable rates for electric service in order to produce revenues sufficient to cover all operating and financial obligations, as defined.

On August 18, 2003, the Commonwealth of Puerto Rico approved Act No. 189, which authorizes the Authority to create, acquire and maintain corporations, partnerships or subsidiary corporations, for profit or non-profit entities.

Basis of Presentation – Blended Component Units

The financial statements of the Authority as of June 30, 2012 and 2011, include the financial position and operations of the Puerto Rico Irrigation Systems (Irrigation Systems) and PREPA Holdings LLC. The Irrigation Systems operate pursuant to the provisions of the Act, and Acts No. 83 and 84, approved on June 20, 1955, regarding the Puerto Rico Irrigation Service, South Coast, and Isabela Irrigation Service, respectively, and the Lajas Valley Public Irrigation Law, approved on June 10, 1953, as amended. PREPA Holdings LLC, a wholly-owned subsidiary of the Authority, was created for the sole purpose of acting as a holding company and has no current operations. PREPA Holdings LLC is the direct parent of the following entities: PREPA Networks, LLC, also known as PREPA.net; PREPA Utilities, LLC; PREPA Oil & Gas, LLC; and InterAmerican Energy Sources, LLC.

The financial statements of the Authority as of June 30, 2012 and 2011, include the financial position and operations of the Irrigation System and PREPA Holdings LLC.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

1. Reporting Entity (continued)

Basis of Presentation – Blended Component Units (continued)

The Irrigations Systems and PREPA Holdings LLC conform to the requirements of Governmental Accounting Standards Board (GASB) No. 39, *Determining Whether Certain Organizations are Component Units*, on its stand-alone financial statements. GASB No. 39 establishes standards for defining and reporting on the financial reporting entity. It also establishes standards for reporting participation in joint ventures. It applies to financial reporting by primary governments, and other stand-alone governments; and it applies to the separately issued financial statements of governmental component units. In addition, this Statement should be applied to governmental and non-governmental component units when they are included in a governmental financial reporting entity.

Condensed financial information as of June 30, 2012 and 2011 and for the years then ended for the Irrigation Systems is as follows:

	2012	2011
	<i>(In thousands)</i>	
Balance sheets:		
Assets:		
Receivables, net	\$ 17,981	\$ 16,555
Prepayments and other assets	240	240
Utility Plant, net of depreciation	<u>20,457</u>	20,254
Total assets	<u>\$ 38,678</u>	\$ 37,049
Liabilities:		
Accounts payable, net	<u>\$ 1,066</u>	\$ 1,066
Statements of revenues, expenditures and changes in net assets:		
Operating revenues	\$ 5,977	\$ 6,002
Operating expenses	<u>(4,348)</u>	(4,126)
	<u>1,629</u>	1,876
Net assets, beginning balance	<u>35,983</u>	34,107
Net assets, ending balance	<u>\$ 37,612</u>	\$ 35,983

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

1. Reporting Entity (continued)

Basis of Presentation – Blended Component Units (continued)

Pursuant to the Act, the Authority is authorized to create subsidiaries in order to, among other things, delegate or transfer any of its rights, powers, functions or duties. The Authority currently has four principal subsidiaries organized in a holding company structure. Currently, only PREPA.Net has significant operations.

PREPA.Net was created to develop strategies for commercializing the surplus capacity of the installed Optical Fiber Network (OFN), adding flexibility and diversification to its operations. PREPA.Net was created on April, 2004 and started commercial operations during fiscal year 2005-2006.

PREPA.Net provides Optical Infrastructure to carriers, ISPs and enhanced services providers – with a highly reliable island wide fiber optic network.

PREPA.Net entered into a long-term lease with PREPA for the Indefeasible Right of Use (IRU) of all PREPA's Optical Infrastructure. PREPA.Net's network features state of the art optical technology that is being used by service providers to reach undersea cable landing stations, wireless network towers, and island wide locations.

In February 2008, PREPA.Net acquired Telecomunicaciones Ultramarinas de Puerto Rico (Ultracom). Ultracom is one of the three submarine cable station administrators in Puerto Rico. This acquisition provides PREPA.Net with International fiber optic capacity and satellite teleport facilities.

PREPA Utilities, LLC, was created for the purpose of investing, financing, constructing and operating industrial projects and other infrastructure relating to the optimization of the Authority's electric infrastructure.

PREPA Oil & Gas, LLC, was created for the purpose of buying, selling, exchanging and otherwise trading or dealing with the export, import, manufacture, production, preparation, handling, storage, and distribution of oil and gas and any other fuels required to satisfy the Authority's power generation needs.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

1. Reporting Entity (continued)

Basis of Presentation – Blended Component Units (continued)

InterAmerican Energy Sources was created for the purpose of investing, developing, financing, constructing and operating renewable energy projects and other infrastructure related to the optimization of the Authority's electric infrastructure. PREPA Utilities, LLC, PREPA Oil & Gas, LLC, and InterAmerican Energy Sources, LLC are currently not operating.

Condensed financial information for PREPA Holdings LLC as of June 30, 2012 and 2011 and for the year then ended is as follows:

	2012	2011
	<i>(In thousands)</i>	
Balance sheets:		
Assets:		
Cash and cash equivalents	\$15,032	\$15,012
Receivables, net	1,577	1,943
Prepayments and other assets	55	77
Utility plant, net of depreciation	9,427	9,769
Other receivables	<u>15,700</u>	–
Total assets	<u><u>\$41,791</u></u>	\$26,801
Liabilities:		
Accounts payable, net	\$20,028	\$ 8,322
Notes payable	<u>8,978</u>	9,819
Total liabilities	<u><u>\$29,006</u></u>	\$18,141
Statements of revenues, expenditures and changes in net assets:		
Operating revenues	\$13,685	\$10,945
Operating expenses	<u>(9,560)</u>	(8,261)
	<u>4,125</u>	2,684
Net assets, beginning balance	<u>8,660</u>	5,976
Net assets, ending balance	<u><u>\$12,785</u></u>	\$ 8,660

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

2. Summary of Significant Accounting Policies

The following is a summary of the most significant accounting policies followed by the Authority in preparing its financial statements:

Basis of Accounting

The accounting and reporting policies of the Authority conform to the accounting rules prescribed by the Governmental Accounting Standards Board (GASB). As such, it functions as an enterprise fund. The Authority maintains its accounting records on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles. Although the Authority is not subject to all Federal Energy Regulatory Commission (FERC) regulations, the Authority has adopted the uniform system of accounts prescribed by FERC.

The Authority follows the provisions of GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, as amended by GASB Statement No. 34, which requires proprietary activities to apply all applicable GASB pronouncements as well as all Financial Accounting Standards Board (FASB) Statements and Interpretations, and Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989, unless the pronouncements conflict or contradict GASB pronouncements.

This pronouncement permits the adoption of all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict or contradict GASB pronouncements. The Authority, as allowed by GASB, decided not to implement any FASB Statement or Interpretation issued after November 30, 1989.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Authority considers all highly liquid debt instruments with maturities of three months or less when purchased to be cash equivalents. Cash and cash equivalents included in the restricted funds are considered cash equivalents for purposes of the statements of cash flows.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Receivables

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions.

Materials, Supplies and Fuel Oil

Materials, supplies and fuel oil inventories are carried at average cost and are stated at the lower of cost or market.

Investments

The Authority follows the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, which require the reporting of investments at fair value in the balance sheet and the recording of changes in fair value in the statement of revenues, expenses and changes in net assets. The fair value is based on quoted market prices and recognized pricing services for certain fixed income securities.

The funds under the 1974 Agreement may be invested in:

- Government obligations, which are direct obligations of, or obligations whose principal and interest is guaranteed by the U.S. Government, or obligations of certain of its agencies or instrumentalities.
- Investment obligations of any of the states or territories of the United States or political subdivisions thereof (other than obligations rated lower than the three highest grades by a nationally recognized rating agency) and repurchase agreements with commercial banks fully secured by U.S. Government obligations.
- Time deposits with Government Development Bank for Puerto Rico (GDB) or the Authority's Trustee under the 1974 Agreement or any bank or trust company member of the Federal Deposit Insurance Corporation having a combined capital and surplus of not less than \$100 million.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Investments (continued)

Effective April 1999, the 1974 Agreement was amended to provide that permitted investments of moneys to the credit of the Self-insurance Fund be expanded (subject to the Authority's adoption of an investment policy with the consent of GDB) to coincide with the investments permitted for the pension fund for employees of the Commonwealth of Puerto Rico and its instrumentalities.

Such investments include various debt instruments, such as mortgage loans and leases, common and preferred stock, real property and various other financial instruments.

Utility Plant

Utility plant is carried at cost, which includes labor, materials, overhead, and an allowance for the cost of funds used during construction (AFUDC). AFUDC represents the cost of borrowed funds used to finance construction work in progress. AFUDC is capitalized as an additional cost of property and as a reduction of interest expense. Capitalized interest expense is reduced by interest income earned on related investments acquired with proceeds of tax-exempt borrowings. Such costs are recovered from customers as a cost of service through depreciation charges in future periods. Capitalized interest during the years ended June 30, 2012 and 2011 amounted to \$11.7 million and \$16.5 million, respectively. These amounts are net of interest income earned on investments amounting to \$.6 million and \$.8 million, respectively.

Capital expenditures of \$1,200 or more are capitalized at cost at the date of acquisition. Maintenance, repairs, and the cost of renewals of minor items of property units are charged to operating expenses. Replacements of major items of property are charged to the plant accounts. The cost of retired property, together with removal cost less salvage, is charged to accumulated depreciation with no gain or loss recognized.

The Authority follows the provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Depreciation

Depreciation is computed on the straight-line method at rates considered adequate to allocate the cost of the various classes of property over their estimated service lives. The annual composite rate of depreciation, determined by the Authority's consulting engineers, was approximately 4.25% for 2012 and 2011.

Unamortized Debt Issuance Expense

Debt issuance expenses and discounts incurred in the issuance of bonds are deferred and amortized using the straight-line method, which approximates the interest method, over the term of the related debt.

For debt refunding debt, the excess of reacquisition cost over the carrying value of long-term debt is deferred and amortized to operating expenses using the straight-line method over the remaining life of the original debt or the life of the new debt, whichever is shorter.

Pension Plan

Pension expense is equal to the statutory required contribution to the employees' retirement system. A pension liability or asset is reported equal to the cumulative difference between annual required contributions and actual contributions.

Other Postemployment Benefits

Other Postemployment Benefits (OPEB) cost of healthcare provided to employees is measured and disclosed using the accrual basis of accounting (see Note 12).

Accounting for Compensated Absences

Accumulated unpaid vacation and sick leave pay are accrued when earned and an additional amount is accrued as a liability for the employer salary-related benefits associated with compensated absences using salary rates in effect at the balance sheets date.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Accounting for Compensated Absences (continued)

The cost of compensated absences expected to be paid in the next twelve months is classified as current accounts payable and accrued liabilities while amounts expected to be paid after twelve months are classified as noncurrent liabilities.

Revenue Recognition, Fuel Costs and Purchase Power

Clients are billed monthly, except for rural clients who are billed bi-monthly. Revenues are recorded based on services rendered during each accounting period, including an estimate for unbilled services. Revenues include amounts resulting from a fuel and purchased power cost recovery clause (Fuel Adjustment Clause), which is designed to permit full recovery through customer billings of fuel costs and purchased power. Fuel costs and purchased power are reflected in operating expenses as the fuel and purchased power are consumed.

Contributions in Lieu of Taxes and Governmental Subsidies

The Act exempts the Authority from all taxes that otherwise would be levied on its properties and revenues by the Commonwealth and its Municipalities, except as follows:

Municipalities

To the extent net revenues, as defined, are available, the Authority is required under the Act to make a contribution in lieu of taxes of 11% to the Commonwealth and the Municipalities of gross electric sales as follows:

The Authority is required under the Act to make a contribution in lieu of taxes to municipalities of the greater of:

- a) Twenty percent of the Authority's Adjusted Net Revenues (Net Revenues, as defined in the 1974 Agreement, less the cost of the Commonwealth rate subsidies);
- b) The cost collectively of the actual electric power consumption of the municipalities; or
- c) The prior five-year moving average of the contributions in lieu of taxes paid to the municipalities collectively.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Contributions in Lieu of Taxes and Governmental Subsidies (continued)

Municipalities (continued)

If the Authority does not have sufficient funds available in any year to pay the contribution in lieu of taxes, the difference is accrued and carried forward for a maximum of three years. The contribution in lieu of taxes to Municipalities can be used to offset accounts receivable balance owed by the Municipalities to the Authority as permitted by law.

Commonwealth of Puerto Rico

To the extent net revenues are available, the Authority is also required under the Act to set aside the remainder of contribution in lieu of taxes of gross electric sales for the purpose of (i) financing capital improvements, (ii) offsetting other subsidies (other than cost of fuel adjustments to certain residential clients) of the Commonwealth, and (iii) any other lawful corporate purpose. Amounts assigned to (ii) above, are classified as a contribution in lieu of taxes in the accompanying statements of revenues, expenses and changes in net assets and reduce the related accounts receivable in the balance sheets.

Contributed Capital

The Authority records contributed capital as income in the year earned. The Authority receives contributed capital in the form of cash and property from residential projects developed by third parties during recent years and local and federal agencies.

Risk Management

The Authority purchases commercial insurance covering casualty, theft, tort claims, natural disaster and other claims covering all risk property (excluding transmission and distribution lines), boiler and machinery, boiler, machinery and public liability. In addition the Authority has a self insured fund to pay cost of repairing, replacing or reconstructing any property damaged or destroyed from, or extraordinary expenses incurred as a result of a cause, which is not covered by insurance required under 1974 agreement.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Estimates

The preparation of the basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications were made to 2011 figures to conform with 2012 presentation.

Interest-Rate Swap Agreements

The Authority follows the provisions of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This statement establishes guidance for the recognition, measurement, and disclosure of information regarding derivative instruments.

The interest-rate swaps are used in the area of debt management to take advantage of favorable market interest rates and to limit interest rate risk associated with variable rate debt exposure.

Under the interest-rate swap programs, the Authority pays fixed and variable rate of interest based on various indices for the term of the variable interest rate Power Revenue Bonds and receives a variable rate of interest, which is also based on various indices. These indices are affected by changes in the market. The net amount received or paid under the swap agreements is recorded as an adjustment to interest expense on the statements of income.

3. Cash and Cash Equivalents

The 1974 Agreement established the General Fund, the Revenue Fund, and certain other funds (see Note 5). All revenues (other than income from investments and construction funds obtained from financing) are deposited in these funds. The moneys held in these funds are presented as unrestricted cash and cash equivalents in the balance sheets.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

3. Cash and Cash Equivalents (continued)

At June 30, 2012 and 2011, the carrying amount and bank balance of cash deposits held by the Authority and restricted cash deposits held by the Trustee under the 1974 Agreement are as follows (in thousands):

	2012		2011	
	Carrying Amount	Bank Balance	Carrying Amount	Bank Balance
Unrestricted	\$199,761	\$ 62,630	\$ 64,856	\$ 43,915
Restricted:				
Held by the Trustee	337,506	337,506	313,531	313,531
Held by the Authority	277,757	277,757	232,166	232,166
	\$815,024	\$677,893	\$ 610,553	\$ 545,697

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Bank's deposits may not be returned. The Commonwealth of Puerto Rico (the Commonwealth) requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized. Deposits maintained in GDB or Economic Development Bank (EDB) are exempt from collateral requirement established by the Commonwealth and thus represents custodial credit risk because in the event of GDB's or EDB's failure the Authority may not be able to recover the deposits. The Authority's policy is to deposit funds with either institution which provides insurance or securities as collateral. Such collateral is held by the Department of the Treasury of the Commonwealth.

All moneys deposited with the Trustee or any other Depositary hereunder in excess of the amount guaranteed by the Federal Deposit Insurance Corporation or other federal agency are continuously secured by lodging with a bank or trust company approved by the Authority and by the Trustee as custodian, or, if then permitted by law, by setting aside under control of the trust department of the bank holding such deposit, as collateral security, Government Obligations or other marketable securities.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

4. Accounts Receivable

At June 30, receivables consist of (in thousands):

	2012	2011
Electric and related services:		
Government agencies and municipalities	\$ 429,254	\$ 464,103
Residential, industrial, and commercial	811,077	720,133
Recoveries under fuel adjustment clause under billed	41,224	28,329
Unbilled services	226,083	203,499
Commonwealth subsidy (fuel adjustment clause) for certain residential clients	6,326	12,653
Miscellaneous accounts and others	37,333	24,257
Allowance for uncollectible accounts	<u>1,551,297</u>	<u>1,452,974</u>
	<u>(234,335)</u>	<u>(214,125)</u>
Receivable from insurance companies and other	1,316,962	1,238,849
Accrued interest on investments	46,540	37,649
Less other non-current receivables, mostly related to the Commonwealth	1,060	1,377
	<u>(104,780)</u>	<u>(95,407)</u>
	\$1,259,782	\$1,182,468

On October 29, 1991, the Authority entered into an agreement with the Commonwealth for the payment of the outstanding fuel adjustment subsidy receivable amounting to approximately \$94 million. Under this agreement, the Commonwealth was paying that amount over a fifteen-year period in installments of approximately \$6.3 million per year, without interest. As of June 30, 2004, the outstanding fuel adjustment subsidy receivable amounted to approximately \$31.6 million. In June 2004, the Legislature of the Commonwealth of Puerto Rico superseded the 1991 agreement with a revised agreement containing an eight-year payment schedule that totals \$55.7 million. The amount owed to the Authority under the 2004 agreement includes an allocation for past due government account receivables in addition to the unpaid balance of the fuel adjustment subsidy. As of June 30, 2012 and 2011, the outstanding receivable amounted to approximately \$6.3 million. This amount is included in other non-current receivables in the accompanying balance sheet.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

4. Accounts Receivable (continued)

In addition, the Authority has other subsidies and reimbursable costs receivable from the Commonwealth, which are reduced by means of charges (accounted for as a contribution in lieu of taxes and to the extent net revenues, as defined, are available) against a portion of the 11% of gross electric sales, after the contribution in lieu of taxes to municipalities, it is required to set aside under the Act. The portion of such receivables and other governmental receivables not expected to be collected during the next fiscal year are reflected in the accompanying balance sheets as other noncurrent receivables.

5. Restricted Assets

At June 30, 2012 and 2011, certain investments and cash deposits of the Authority were restricted to comply with long-term principal and interest debt service requirements (sinking funds) as well as for self-insurance. These restricted assets are held by the Trustee under the 1974 Agreement (see Note 3) in the following funds:

1974 Reserve Account – Reserve for payment of principal of and interest on Power Revenue Bonds in the event moneys in Bond Service Account or Redemption Account are insufficient for such purpose.

1974 Self-Insurance Fund – Fund to pay the cost of repairing, replacing or reconstructing any property damaged or destroyed from, or extraordinary expenses incurred as a result of a cause, which is not covered by insurance required under the 1974 Agreement. The 1974 Self-Insurance Fund also serves as an additional reserve for the payment of the principal of and interest on the Power Revenue Bonds, and meeting the amortization requirements to the extent that moneys in the Bond Service Account, the Redemption Account and the 1974 Reserve Account are insufficient for such purpose. During fiscal years 2011-2012 and 2010-2011, the Authority deposited \$5 million and \$10 million, respectively to the 1974 Self-Insurance Fund.

Bond Service Account and Redemption Account (1974 Sinking Fund) – Current year requirements for principal of and interest on Power Revenue Bonds.

Puerto Rico Electric Power Authority
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Notes to Audited Financial Statements (continued)

5. Restricted Assets (continued)

At June 30, cash, cash equivalents and investments held by the Trustee consist of (in thousands):

	2012		2011	
	Cash and Cash Equivalents	Investments	Cash and Cash Equivalents	Investments
1974 Sinking Fund - Principal	\$ 185,974	\$ —	\$ 175,455	\$ —
1974 Sinking Fund – Interest and Capitalized Interest	141,512	154,548	138,076	153,958
1974 Reserve Account	—	401,735	—	377,903
1974 Self-Insurance Fund	10,020	80,352	—	84,645
	\$337,506	\$636,635	\$313,531	\$616,506

Investments held by Trustee under the 1974 Agreement are invested exclusively in securities of the U.S. Government and its agencies.

The Authority also has cash and investment securities held by the trust department of a commercial bank restricted for the following purposes:

1974 Construction Fund – Special fund created by the 1974 Agreement. The proceeds of any Power Revenue Bonds issued for the purpose of paying the cost of acquiring or constructing improvements, together with the money received from any other source for such purpose, except proceeds which are (i) applied to the repayment of advances, (ii) deposited in the 1974 Reserve Account, (iii) deposited in the Bond Service Account as capitalized interest or (iv) used for the payment of financing expenses, shall be deposited in the 1974 Construction Fund and held by the Authority in trust.

Reserve Maintenance Fund – Fund to pay the cost of unusual or extraordinary maintenance or repairs, not recurring annually, and renewals and replacements, including major items of equipment. The Reserve Maintenance Fund also serves as an additional reserve for the payment of principal of and interest on the Power Revenue Bonds and meeting the amortization requirements to the extent that moneys in the 1974 Sinking Fund, including money in the 1974 Reserve Account, are insufficient for such purpose. During fiscal years 2010-2011, the Authority deposited \$5 million to the 1974 Reserve Maintenance Fund.

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Notes to Audited Financial Statements (continued)

5. Restricted Assets (continued)

At June 30, 2012 and 2011, the 1974 Construction Fund and Reserve Maintenance Fund consist of (in thousands):

	2012		2011	
	Cash and Cash Equivalents	Investments	Cash and Cash Equivalents	Investments
1974 Construction Fund	\$275,107	\$ 1,101	\$225,254	\$1,099
Reserve Maintenance Fund	—	15,809	5,012	10,679
Other Restricted Funds	1,900	—	1,900	—
PREPA Client Fund	750	2,002	—	500
	\$277,757	\$18,912	\$232,166	\$12,278

Following is the composition of the investments in the 1974 Construction Fund and other special funds (in thousands):

	2012	2011
U.S. Government obligations	\$ 1,101	\$ 1,099
Certificate of deposit	17,811	11,179
	\$18,912	\$12,278

Puerto Rico Electric Power Authority
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Notes to Audited Financial Statements (continued)

5. Restricted Assets (continued)

Investments

The following table provides a summary of the Authority's investments by type at June 30, 2012 (in thousands):

June 30, 2012					
	Coupon Rate	Maturity Dates	Face Value	Fair Value	% of Total Portfolio
1974 Reserve Maintenance Fund					
Federal National Mortgage Association	0.70%	Mar-15	5,000	\$ 5,005	31.7%
Certificate of Deposits	.16 to .19%	7/2012 to 9/2012	10,804	10,804	68.3%
			<u>Total Portfolio</u>	<u>15,809</u>	
1974 Self Insurance Reserve Fund					
Federal Home Loan Mortgage Corp.	5.00%	Mar-23	1,386	1,489	1.9%
Federal National Mortgage Association	.60 to 5.50%	10/2014 to 06/2024	39,987	40,761	50.7%
Federal Farm Credit Bank	0.60%	May-15	10,000	10,004	12.5%
Corporate Issues	.60 to 8.50%	9/2014 to 08/2019	10,320	12,046	15.0%
Certificate of Deposit	0.170%	Jul-12	16,052	16,052	20.0%
			<u>Total Portfolio</u>	<u>80,352</u>	
1974 Reserve Account					
Federal Home Loan Mortgage Corporation	1.10 to 1.30%	1/2017 to 02/2017	25,000	25,148	6.3%
Federal Home Loan Bank	1.240%	Mar-17	20,000	20,027	5.0%
Federal National Mortgage Association	1.20 to 1.75%	10/2016 to 05/2017	75,000	75,235	18.7%
Federal Farm Credit Bank	1.19 to 1.30%	03/2017 to 05/2017	40,000	40,135	10.0%
Certificates of Deposits	.14 to .40%	07/2012 to 08/2012	241,190	241,190	60.0%
			<u>Total Portfolio</u>	<u>401,735</u>	
Sinking Fund - Capitalized Interest					
Federal Home Loan Mortgage Corporation	0.625%	Dec-12	14,060	14,089	9.1%
Federal Home Loan Bank	.87 to 2.00%	08/2012 to 11/2012	10,600	10,632	6.9%
Federal National Mortgage Association	.375 to 1.00%	10/2012 to 12/2012	10,535	10,551	6.8%
US Bank Money Market	.039 to 1.00%	7/2012 to 09/2012	108,404	108,404	70.1%
US Treasury Note	0.625%	Jun-12	1,000	1,000	0.6%
Corporate Issues	.55 to 6.375%	Jul-12	9,780	9,872	6.4%
			<u>Total Portfolio</u>	<u>154,548</u>	
1974 PREPA Client					
Certificates of Deposits			<u>2,002</u>	<u>2,002</u>	100.0%
			<u>Total Portfolio</u>	<u>2,002</u>	
1974 Construction Fund					
Other - Rural Electricity Administration (REA)			<u>1,101</u>	<u>1,101</u>	100.0%
			<u>Total Portfolio</u>	<u>1,101</u>	
			<u>\$</u>	<u>655,547</u>	

Puerto Rico Electric Power Authority
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Notes to Audited Financial Statements (continued)

5. Restricted Assets (continued)

Investments (continued)

The following table provides a summary of the Authority's investments by type at June 30, 2011 (in thousands):

	June 30, 2011				% of Total Portfolio
	Coupon Rate	Maturity Dates	Face Value	Fair Value	
1974 Reserve Maintenance Fund					
Federal National Mortgage Association					
Federal Farm Credit Bank	0.16%	Jun-14	5,000	\$ 4,979	46.6%
Certificates of Deposits	.14 to 1.05%	7/2011 to 8/2011	5,700	5,700	53.4%
			<u>Total Portfolio</u>	<u>10,679</u>	
1974 Self Insurance Reserve Fund					
Federal Home Loan Mortgage Corp.	.825 to 1.05%	10/2013 to 6/2014	26,700	26,682	31.5%
Certificates of Deposit	.15 to .17%	Jul-11	57,963	57,963	68.5%
			<u>Total Portfolio</u>	<u>84,645</u>	
1974 Reserve Account					
Federal Home Loan Mortgage Corporation	1.93 to 2.00%	8/2014 to 8/2015	31,300	31,354	8.3%
Federal Home Loan Bank	.625 to 2.00%	9/2015 to 12/2015	78,285	77,793	20.6%
Federal National Mortgage Association	1.63 to 2.08%	10/2015 to 6/2016	79,800	78,769	20.8%
Federal Farm Credit Bank	1.85 to 2.25%	8/2015 to 5/2016	76,560	76,576	20.3%
Certificates of Deposits	.12 to .20%	Jul-11	113,411	113,411	30.0%
			<u>Total Portfolio</u>	<u>377,903</u>	
Sinking Fund - Capitalized Interest					
US Treasury Note	.625 to 4.625%	7/2011 to 8/2011	37,579	38,260	24.9%
Federal Home Loan Mortgage Corporation	0.63%	Dec-12	14,060	14,107	9.2%
Federal Home Loan Bank	.20 to 2.00%	9/2011 to 11/2012	31,220	31,466	20.4%
Federal National Mortgage Association	.17 to 1.25%	7/2011 to 12/2012	21,839	21,913	14.2%
US Bank Money Market	0.10%		37,400	37,387	24.3%
Certificates of Deposits	0.14%	Jul-11	10,825	10,825	7.0%
			<u>Total Portfolio</u>	<u>153,958</u>	
1974 Construction Fund					
Other - Rural Electricity Administration (REA)			1,099	1,099	100.0%
			<u>Total Portfolio</u>	<u>1,099</u>	
1974 PREPA Client					
Certificates of Deposits			500	500	100.0%
			<u>Total Portfolio</u>	<u>500</u>	
			<u>\$ 628,784</u>		

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Notes to Audited Financial Statements (continued)

5. Restricted Assets (continued)

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The 1974 Trust Agreement limits investments in:

- Government obligations, which are direct obligations of, or obligations whose principal and interest is guaranteed by the U.S. Government, or obligation of certain of its agencies or instrumentalities.
- Investment obligation of any of the states or territories of the United States or political subdivisions therefore (other than obligations rated lower than the three highest grades by a nationally recognized rating agency) and repurchase agreements with commercial banks fully secured by U.S. Government Obligations.
- Time deposits with GDB or the Authority's Trustee under the 1974 Agreement or any bank or trust company member of the Federal Deposit Insurance Corporation having a combined capital and surplus of not less than \$100 million.
- Self-insurance fund (sinking fund) and PREPA client fund are allowed to invest in corporate issues, with certain restrictions (40% of the total fixed income portfolio).

As of June 30, 2012, the Authority's investments in Federal Home Loan Mortgage, Federal Home Loan Bank, Federal National Mortgage Association and Federal Farm Credit Bank and Freddie Mac were rated AA+ by Standard & Poor's (S&P) and Aaa by Moody's Investors Service.

Concentration Credit Risk

Concentration of credit risk is the risk of loss attributable to the magnitude of investment in a single issuer by five percent or more of total investment. The Authority's investment policy does not contain a limitation to invest in the securities of single issuer. As June 30, 2012, more than 5% of the Authority's total investments are in Federal Home Loan Mortgage, Federal Home Loan Bank, Federal National Mortgage Association, Federal Farm Credit Bank, and Certificate of Deposits.

Puerto Rico Electric Power Authority
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Notes to Audited Financial Statements (continued)

5. Restricted Assets (continued)

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. In accordance with the 1974 Trust Agreement, the Authority manages its exposure to declines in fair values by limiting the maturity of its investment portfolio up to 5 years. Information about the sensitivity of the fair values of the Authority's investment to market interest fluctuations is provided by the following tables that show the distribution of the investments by maturity as of June 30, 2012 and 2011 (in thousands):

Investment Type	Fair Value	June 30, 2012		
		Less than 1 year	1-5 years	Total
Federal Home Loan Mortgage Corporation	\$ 40,726	\$ 14,089	\$ 26,637	\$ 40,726
Federal Home Loan Bank	30,659	10,632	20,027	30,659
Federal National Mortgage Association	131,552	10,551	121,001	131,552
Federal Farm Credit Bank	50,139	—	50,139	50,139
Certificate of Deposits	270,047	270,047	—	270,047
Other-REA Investment	1,101	—	1,101	1,101
US Treasury Note	1,000	1,000	—	1,000
US Bank Money Market	108,404	108,404	—	108,404
Corporate Issues	21,919	9,873	12,046	21,919
Total Investments				\$655,547

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Notes to Audited Financial Statements (continued)

5. Restricted Assets (continued)

Interest Rate Risk (continued)

Investment Type	Fair Value	Investment Maturities			Total
		Less than 1 year	1-5 years		
Federal Home Loan Mortgage					
Corporation	\$ 45,461	\$ —	\$ 45,461	\$ 45,461	
Federal Home Loan Bank	135,941	—	135,941	135,941	
Federal National Mortgage					
Association	100,682	—	100,682	100,682	
Federal Farm Credit Bank	81,553	—	81,553	81,553	
Certificate of Deposits	188,401	188,401	—	188,401	
US Treasury Note	38,260	38,260	—	38,260	
US Bank Money Market	37,387	37,387	—	37,387	
Other – REA Investment	1,099	—	1,099	1,099	
Total Investments					\$628,784

6. Utility Plant

As of June 30, utility plant consists of:

	2012	2011
	<i>(In thousands)</i>	
Distribution	\$ 3,582,507	\$ 3,331,748
Transmission	2,061,408	2,042,152
Production	2,713,145	2,615,803
Other production	1,527,748	1,460,560
Hydroelectric	135,821	130,846
General	1,628,416	1,523,043
Irrigation systems	34,150	33,597
Fiber Network	20,106	18,862
	11,703,301	11,156,611
Less accumulated depreciation	(5,768,095)	(5,364,446)
	5,935,206	5,792,165
Construction in progress	863,970	1,020,437
	\$6,799,176	\$ 6,812,602

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Notes to Audited Financial Statements (continued)

6. Utility Plant (continued)

Utility plant activity for the years ended June 30, 2012 and 2011 was as follows (in thousands):

	2011			2012
	Beginning Balance	Increases	Decreases	Transfers
Utility plant	\$ 11,156,611	\$ –	\$(10,924)	\$ 557,614
Construction work in progress	1,020,437	401,147	–	(557,614)
Total utility plant, as restated	<u>12,177,048</u>	<u>401,147</u>	<u>(10,924)</u>	<u>–</u>
 Less:				
Accumulated depreciation	(5,364,446)	(414,573)	10,924	–
Total utility plant, net as restated	<u>\$ 6,812,602</u>	<u>\$ (13,426)</u>	<u>\$ –</u>	<u>\$ 6,799,176</u>

	2010			2011
	Beginning Balance	Increases	Decreases	Transfers
Utility plant, as restated	\$10,573,128	\$ –	\$(8,814)	\$ 592,297
Construction work in progress	1,182,225	430,509	–	(592,297)
Total utility plant, as restated	<u>11,755,353</u>	<u>430,509</u>	<u>(8,814)</u>	<u>–</u>
 Less:				
Accumulated depreciation	(5,022,563)	(350,697)	8,814	–
Total utility plant, net as restated	<u>\$ 6,732,790</u>	<u>\$ 79,812</u>	<u>\$ –</u>	<u>\$ 6,812,602</u>

Construction work in progress at June 30, 2012 and 2011 consists principally of expansions and upgrades to the electric generation, distribution and transmission systems.

7. Defeasance of Debt

In prior years, the Authority has refunded in advance certain Power Revenue Bonds and other obligations by placing the proceeds of new debt in an irrevocable trust to provide for future debt service payments on such bonds. Accordingly, the trust accounts, assets, and liabilities for the defeased bonds are not included in the Authority's financial statements. At June 30, 2012, \$4,030.6 million of Power Revenue Bonds which remain outstanding are considered defeased.

Puerto Rico Electric Power Authority
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Notes to Audited Financial Statements (continued)

8. Notes Payable

The following is a summary of notes payable as of June 30, 2012 (in thousands):

June 30, 2012					
Maturity Date	Effective Interest Rate	Current Liabilities	Long-Term Debt	Total	
Notes payable, unrestricted:					
Line of credit of \$64.2 million to fund payments required under a settlement agreement with municipalities	June 2014 .70%+LIBOR (V)	\$ 9,700	\$10,458	\$ 20,158	
Loan of \$41.5 to sale at discount the funds assigned by the Legislature of Puerto Rico through Joint Resolution 1290 of August 24, 2004, to pay the amount owed by the Commonwealth regarding the fuel subsidy	Nov 2012 4.375% (V)	4,901	—	4,901	
Revolving line of credit of \$210 million to finance working capital	Jul 2012 1.75%+LIBOR (V)	140,000	—	140,000	
Revolving line of credit of \$500 million to finance working capital	May 2013 1.75%+LIBOR (V)	399,995	—	399,995	
Revolving line of credit of \$50 million to finance fuel oil purchases	Jun 2012 6.00% (F)	49,031	—	49,031	
Line of credit of \$25 million to finance improvements to Isabela Irrigation System P.R. (ULTRACOM)	June 2018 7.00% (V)	750	—	750	
	Feb 2023 3.25% (F)	842	8,136	8,978	
Total notes payable			\$605,219	\$18,594	\$623,813

(V) – variable interest rate

(F) – fixed interest rate

Puerto Rico Electric Power Authority
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Notes to Audited Financial Statements (continued)

8. Notes Payable (continued)

The following is a summary of notes payable as of June 30, 2011 (in thousands):

	June 30, 2011				
	Maturity Date	Effective Interest Rate	Current Liabilities	Long-Term Debt	Total
Notes payable, unrestricted:					
Line of credit of \$64.2 million to fund payments required under a settlement agreement with municipalities	June, 2014	.70%+LIBOR(v)	\$ 9,700	\$ 20,158	\$ 29,858
Loan of \$41.5 to sale at discount the funds assigned by the Legislature of Puerto Rico through Joint Resolution 1290 of August 24, 2004, to pay the amount owed by the Commonwealth regarding the fuel subsidy	Nov- 2013	4.375%(v)	5,853	4,901	10,754
Revolving line of credit of \$150 million to Working capital	June-2012	1.75%+LIBOR(v)	150,000	—	150,000
Line of credit of \$35.0 million for the construction of Gasoducto del Sur	Aug - 2011	6.00%(f)	26,485	—	26,485
Line of credit of \$25 million to finance improvements to Isabela Irrigation System	June-2018	7.00%(v)	750	—	750
PREPA.Net - Loan used in the acquisition of subsidiary, Ultramarinas de P.R. (ULTRACOM)	Feb-2023	3.25%(v)	912	8,978	9,890
Total notes payable			\$193,700	\$ 34,037	\$227,737

(V) – variable interest rate

(F) – fixed interest rate

Puerto Rico Electric Power Authority
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Notes to Audited Financial Statements (continued)

8. Notes Payable (continued)

Short-term debt activity for the years ended June 30, 2012 and 2011 was as follows:

	2012	2011
	<i>(In thousands)</i>	
Balance at beginning of year	\$ 193,700	\$ 15,090
Proceeds and transfers from long-term debt	603,557	339,800
Payment of short-term debt	<u>(192,038)</u>	<u>(161,190)</u>
Balance at end of year	<u>\$ 605,219</u>	<u>\$ 193,700</u>
Notes payable – short-term:		
Unrestricted	\$ 605,219	\$ 193,700
Total of notes payable	\$ 605,219	\$ 193,700

9. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities at June 30, 2012 and 2011 were as follows:

	2012	2011
	<i>(In thousands)</i>	
Accounts payable, accruals, and withholdings in process of payment	\$ 650,759	\$ 898,910
Additional accruals and withholdings:		
Injuries and damages and other	21,396	23,911
Accrued vacation and payroll benefits	62,719	60,609
Accrued sick leave and payroll benefits - exclusive of benefits to be liquidated after one year of approximately \$139.9 million in 2012 and 2011	19,770	26,665
Accrued compensation	25,786	22,647
Accrued pension plan contribution and withholding from employees:		
Employees' Retirement System	17,679	16,588
Employees health plan	23,246	13,187
Contribution in lieu of taxes	189,900	176,514
Other accrued liabilities	27,408	12,659
	\$ 1,038,663	\$ 1,251,690

Puerto Rico Electric Power Authority
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Notes to Audited Financial Statements (continued)

10. Other Current Liabilities Payable from Restricted Assets

	2012	2011
	<i>(In thousands)</i>	
Contract retainage	\$ 8,738	\$ 10,209
Other liabilities	42,808	59,199
	<u>\$ 51,546</u>	<u>\$ 69,408</u>

11. Long-Term Debt

At June 30, long-term debt consists of:

	2012	2011
	<i>(In thousands)</i>	
Power Revenue Bonds payable:		
Publicly offered at various dates from 1997 to 2012, interest rates ranging from 2% to 6.25%, maturing to 2042	\$ 8,234,090	\$ 7,780,890
Plus unamortized premium and debt reacquisition costs	77,599	80,362
Revenue bonds payable, net	<u>8,311,689</u>	<u>7,861,252</u>
Notes payable and bond anticipation notes	<u>623,813</u>	<u>227,736</u>
	<u>8,935,502</u>	<u>8,088,988</u>
Less current portion of long-term debt:		
Notes payable from unrestricted assets	605,219	193,700
Power revenue bonds	379,975	358,552
Current portion of long-term debt from restricted assets	<u>379,975</u>	<u>358,552</u>
Total current portion of long-term debt	<u>985,194</u>	<u>552,252</u>
	<u>\$ 7,950,308</u>	<u>\$ 7,536,736</u>

Puerto Rico Electric Power Authority
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Notes to Audited Financial Statements (continued)

11. Long-Term Debt (continued)

Long-term debt activity for the years ended June 30, 2012 and 2011 was as follows:

	2012	2011
	<i>(In thousands)</i>	
Long-term debt excluding current portion	\$8,088,988	\$ 7,587,114
New issues:		
Power revenue bonds	630,110	355,730
Power revenue refunding bonds	19,890	218,225
Debt discount and excess reacquisition costs on new bond issues, – net	(4,751)	(10,548)
Defeasance of bonds	(21,345)	(215,940)
Debt discount and excess reacquisition costs on cancelled bonds, – net	(499)	15,767
Notes payable	866,648	172,062
	9,579,041	8,122,410
Payments:		
Power revenue bond – July 1	(175,455)	–
Power revenue bond – January 1	–	–
Notes payable	(470,572)	(36,119)
Total payments	(646,027)	(36,119)
Amortization of debt discount and excess reacquisition costs	2,488	2,697
Balance at end of year	\$8,935,502	\$ 8,088,988
Current portion of notes payable	\$ 605,219	\$ 193,700
Current portion of power revenue bonds	379,975	358,552
Total current portion of long-term debt	\$ 985,194	\$ 552,252

Puerto Rico Electric Power Authority
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Notes to Audited Financial Statements (continued)

11. Long-Term Debt (continued)

Power Revenue Bonds Payable

During fiscal year 2012, the Authority issued its Power Revenue Bonds, Series 2012A and 2012B. A summary of the net proceeds of the Power Revenue Bonds, Series 2012A and 2012B and the application of the proceeds follows (in thousands):

Sources:

Principal amount of the bonds	\$650,000
Net original issue premium	(597)
Other available moneys	382
Total sources	<u>\$649,785</u>

Application of net proceeds:

Deposit to 1974 construction fund	\$359,529
Deposit to reserve account	17,183
Deposit to escrow fund for the refunded bonds	22,130
Capitalized interest	82,556
Payment of Line of Credit and accrued interest	161,901
Underwriting discount and estimated legal, printing and other financing expenses	6,486
Total application of proceeds	<u>\$649,785</u>

During fiscal year 2011, the Authority issued its Power Revenue Bonds, Series DDD and EEE. In addition, Series EEE was issued under the Build America Bonds (BAB's) federal program, for the purpose of financing the cost of its Capital Improvements Program (CIP). Under this program the Authority will receive a credit from the United States Treasury equal to 35% of the stated interest paid on such bonds.

Puerto Rico Electric Power Authority
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Notes to Audited Financial Statements (continued)

11. Long-Term Debt (continued)

Power Revenue Bonds Payable (continued)

A summary of the net proceeds the Power Revenue Bonds, Series DDD and EEE and the application of the proceeds follows (in thousands):

Sources:

Principal amount of the bonds	\$573,955
Net original issue premium	14,310
Deposits in bond service accounts	2,552
Authority Contribution	150
Total sources	<hr/> 590,967

Application of net proceeds:

Deposit to 1974 construction fund	284,466
Deposit to reserve account	14,050
Deposit to escrow fund for the refunded bonds	219,929
Capitalized interest on bonds through July 1, 2012	12,377
Payment of accrued interest on bond anticipation notes	150
Underwriting discount and estimated legal, printing and other financing expenses	<hr/> 9,995
Repayment of bond anticipation notes	<hr/> 50,000
Total application of proceeds	<hr/> \$590,967

Maturities of the Power Revenue Bonds Series 2012A, issued during fiscal year 2012 range July 1, 2028 to July 1, 2042. The Series 2012A bear fixed interest rates ranging from 5.95% to 6.25%. Interest on the Series 2012A is payable on each July 1 and January 1.

Maturities of Power Revenue Bonds Series 2012A issued during fiscal year 2012 on July 1, 2016. The Series 2012B bear a fixed interest rates ranging from 2.50% to 5.00%. Interest on the Series 2012B is payable on each July 1 and January 1.

Maturities of the Power Revenue Bonds Series DDD issued during fiscal year 2011 range from July 1, 2020 to July 1, 2024. The Series DDD Bonds bear fixed interest rates ranging from 3.625% to 3.875%. Interest on the Series DDD Bonds is payable on each July 1 and January 1.

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Notes to Audited Financial Statements (continued)

11. Long-Term Debt (continued)

Power Revenue Bonds Payable (continued)

Maturities of the Power Revenue Refunding Bonds Series EEE issued during fiscal year 2011 range from July 1, 2020 to July 1, 2040. The Series EEE Bonds bear a coupon rate of 6.1%. Interest on the Series EEE Bonds is payable quarterly on each July 1, October 1, January 1 and April 1.

The Authority has issued Power Revenue Bonds pursuant to the 1974 Agreement principally for the purpose of financing the cost of improvements; as such term is defined in the 1974 Agreement, and subject to the conditions and limitations set forth therein.

In the 1974 Agreement, the Authority covenants to fix, charge, and collect rates so that revenues will be sufficient to pay current expenses and to provide the greater of (i) the required deposits or transfers under the Sinking Fund, the 1974 Self-insurance Fund and the Reserve Maintenance Fund or (ii) 120% of the aggregate principal and interest requirements for the next fiscal year on account of all outstanding Power Revenue Bonds.

Gross revenues, exclusive of income on certain investments, less current expenses as defined in the Agreement have been pledged to repay Power Revenue Bonds principal and interest.

Bond Anticipation Notes

Bond anticipation notes (BANs) are used primarily to provide interim construction financing and are usually retired with the proceeds of long-term debt.

Puerto Rico Electric Power Authority
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Notes to Audited Financial Statements (continued)

11. Long-Term Debt (continued)

Interest-Rate Swap Agreements

To protect against the potential of rising interest rates, the Authority entered into quarterly separate pay-fixed, receive-variable interest-rate swaps at a cost anticipated to be less than what the Authority would have paid to issue fixed-rate debt. On June 30, 2012 and 2011, the Authority had the following derivative instruments outstanding: (in thousands)

Item	Type	Objective	Notional Amount	Effective Date	Maturity Date	Terms	Counterparty Credit Rating
A	Pay-Fixed Interest Rate Swap	Hedge of changes in cash flows on the Series UU Bonds	\$25,525	5/3/2007	7/1/2017	Pay 4.014%; receive 5Y SIFMA	Aa3/A+
B	Pay-Fixed Interest Rate Swap	Hedge of changes in cash flows on the Series UU Bonds	17,000	5/3/2007	7/1/2018	Pay 4.054%; receive 5Y SIFMA	Aa3/A+
C	Pay-Fixed Interest Rate Swap	Hedge of changes in cash flows on the Series UU Bonds	29,055	5/3/2007	7/1/2020	Pay 4.124%; receive 5Y SIFMA	Aa3/A+
D	Pay-Fixed Interest Rate Swap	Hedge of changes in cash flows on the Series UU Bonds	14,570	5/3/2007	7/1/2025	Pay 4.232%; receive 67% 3M LIBOR + 0.68%	Aa3/A+
E	Pay-Fixed Interest Rate Swap	Hedge of changes in cash flows on the Series UU Bonds	169,532	5/3/2007	7/1/2029	Pay 4.08%; receive 67% 3M LIBOR + 0.52%	Aa3/A+
F	Pay-Fixed Interest Rate Swap	Hedge of changes in cash flows on the Series UU Bonds	72,800	5/3/2007	7/1/2031	Pay 4.286%; receive 67% 3M LIBOR + 0.70%	Aa3/A+
G	Pay-Fixed Interest Rate Swap	Hedge of changes in cash flows on the Series UU Bonds	83,343	5/3/2007	7/1/2029	Pay 4.08%; receive 67% 3M LIBOR + 0.52%	Aa3/A+
H	Basis Swap Goldman Sachs	Hedges tax risk on underlying fixed rate bonds (various) and provides expected positive cash flow accrual	550,000	7/1/2008	7/1/2037	Pay SIFMA; receive 62% 3M LIBOR + 0.29% + 0.4669%	A2/A
I	Basis Swap Deutsche Bank	Hedges tax risk on underlying fixed rate bonds (various) and provides expected positive cash flow accrual	200,000	5/10/2012	7/1/2037	Pay SIFMA; receive 62% 3M LIBOR + 0.29% + 0.4669%	A2/A+
J	Basis Swap Royal Bank of Canada	Hedges tax risk on underlying fixed rate bonds (various) and provides expected positive cash flow accrual	400,000	5/10/2012	7/1/2037	Pay SIFMA; receive 62% 3M LIBOR + 0.29% + 0.4669%	Aa3/AA-
Total			<u>\$1,561,825</u>				